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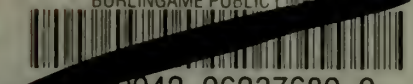

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BusinessWeek

5, 2004

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In Praise of Design

This week we feature the annual Industrial Design Excellence Awards, presented by the Industrial Designers Society of America and sponsored by *BusinessWeek*. It is our 14th year of association with the IDSA. While the society is based in the U.S., the competition is global, with an international jury of leaders in the field and honors for the best-designed products in the world for business, industrial, consumer, research, medical, and scientific markets. In 2004 there were 37 gold, 45 silver, and 48 bronze winners. Of the total 130 winners, 33 were from 14 countries outside the U.S.—Australia, Britain, Canada, Denmark, France, Germany, Ireland, Israel, Japan, Korea, the Netherlands, New Zealand, Sweden, and Taiwan.

BusinessWeek is the only major business magazine to sponsor a global design competition. The driving force, from our first design-awards issue in 1991, has been our own Bruce Nussbaum. While his day job is editorial page editor, he has also been a keen observer of design trends for nearly two decades. His breakthrough report, "'I can't work this ?#!!@/ thing!'" (1991), took on technology run amok, spotlighting consumer products that were impossible to use—think flashing VCR clocks. Most recently, he profiled design innovators IDEO ("The power of design," Cover Story, May 17).

The hope of our original collaboration with the IDSA was to serve as an inspiration to American industrial designers, who were overshadowed by their European and Japanese counterparts in the 1970s and '80s. During his early days on the beat, Nussbaum says design was an afterthought in corporate boardrooms—if it was given any consideration at all. "Companies used design like paint, to slap on a color or a fancy shape after the engineers and marketing people came up with a product," he recalls.

Now designers are creating not just products and services but also shaping how customers experience them. "Design has become an integral part of a company's core competence," Nussbaum says. And designers have learned to speak the language of business. These days, traditional marketing methods—focus groups and market research—are giving way to the tools of design analysis, which focus on behavior.

Through the years, our issue has highlighted the leading edge of design. *BusinessWeek*'s focus has been on functionality and ease of use, as well as on style. Often, less is more.

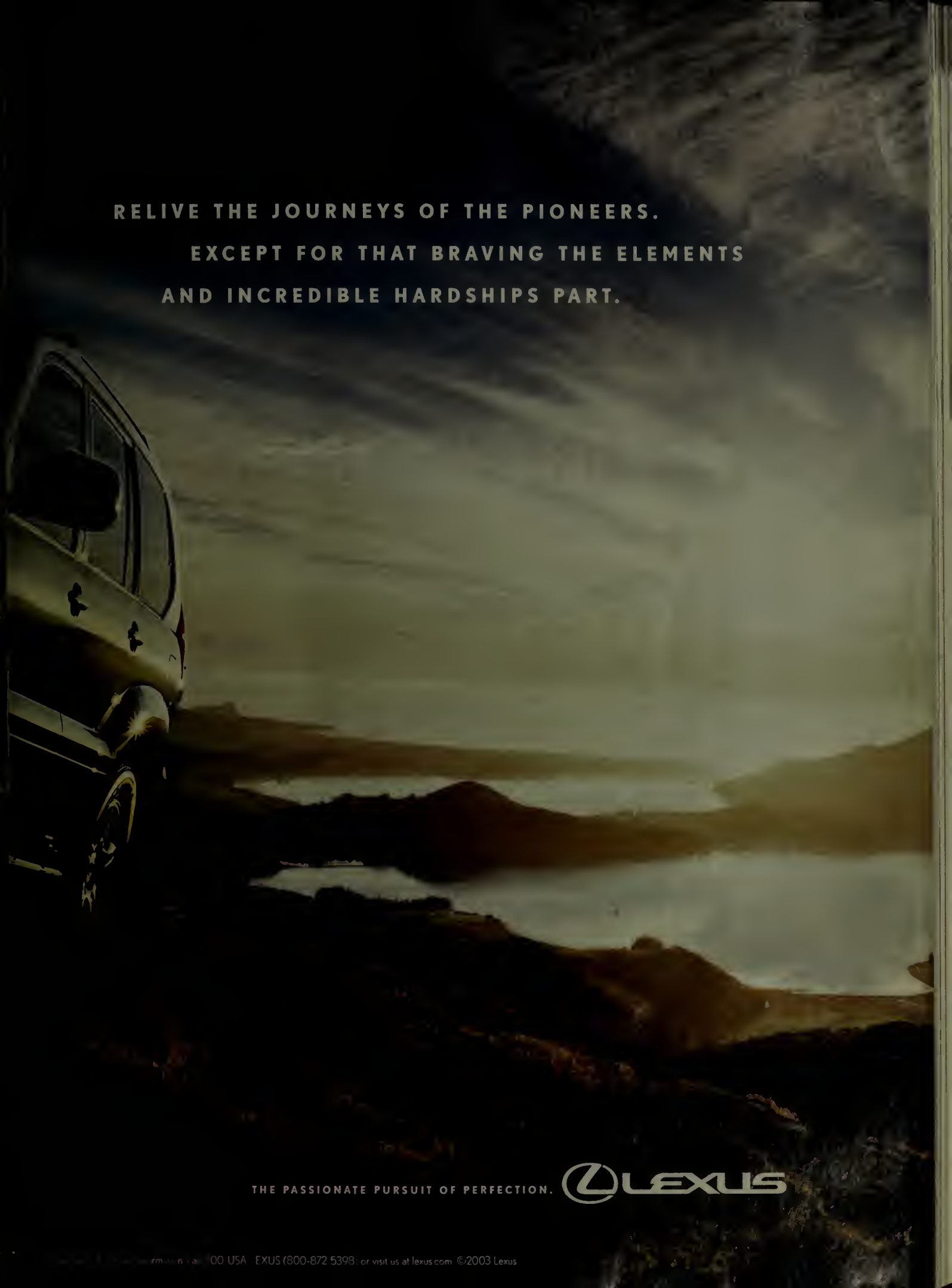
Our report on the best in industrial design begins on page 60, and you'll find a complete list of winners plus an expanded photo gallery on BusinessWeek Online. There's plenty to drool over.

Stephen B. Shepard

EDITOR-IN-CHIEF

A trip across the frontier certainly isn't what it used to be. Especially when you undertake the journey in a GX. A 4.7-liter V8 provides the brute strength necessary for taming any wilderness. While Downhill Assist Control (DAC) and Hill-start Assist Control (HAC) help you manage the inevitable ups and downs. And unlike those hardy souls from days gone by, you won't have to sacrifice the comforts of home, because they've been thoughtfully provided. In short, the GX offers everything you need to indulge your pioneer spirit, without having to leave the 21st century behind. **THE GX 470**

shown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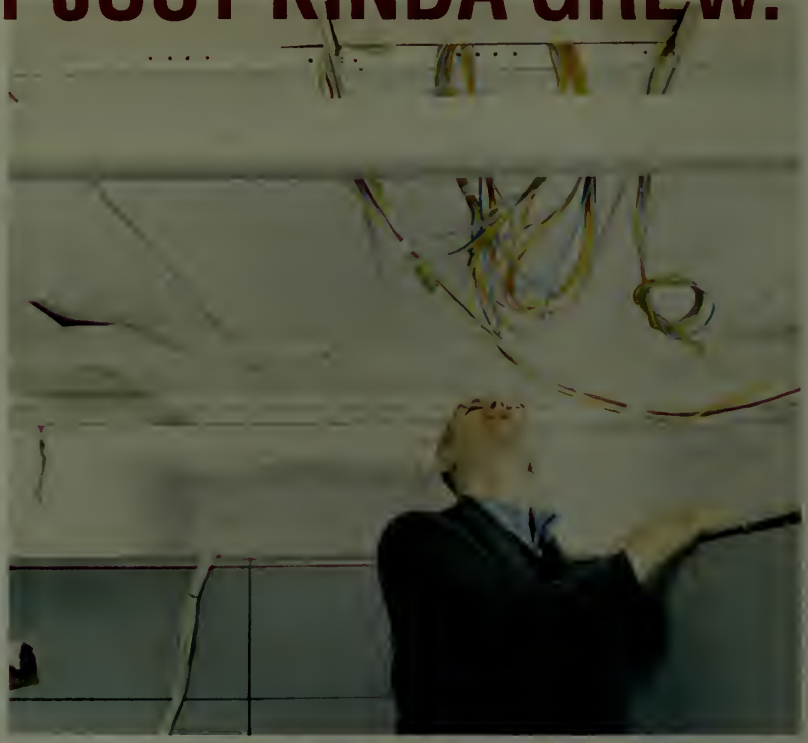

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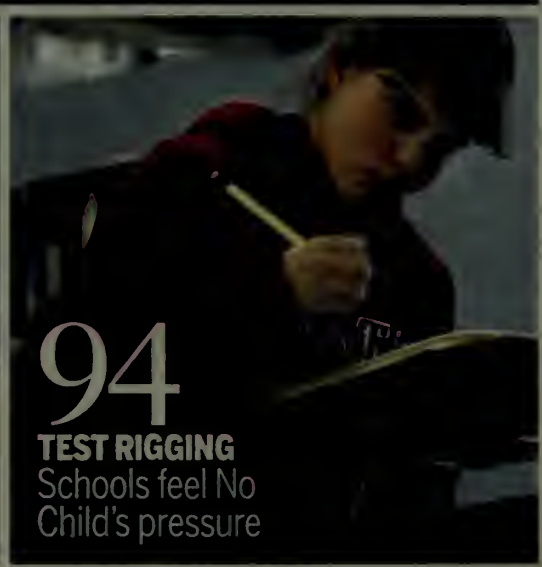

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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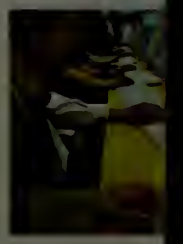
Dear Larry Ellison: Try A Little Tenderness

Oracle has been trying to acquire software rival PeopleSoft for more than a year, but so far the bid has generated only hard feelings. If you're serious about this marriage, it's time to show you care

"I Want to Prove Dr. Atkins Was Right"

The late diet guru was criticized for the lack of scientific data backing up his call to cut out the carbs. Now, his widow, Veronica, says she's funding research in the hopes of validating his theories on nutrition

Fear and Fascination in Cyber China



Torn between Chinese dot-com IPOs with hot growth prospects and a too-hot economy, investors don't know whether they're coming or going

The Hard Life of a Golfing Great

From the suicide of his father when he was nine to the near fatal car accident at the height of his career, Ben Hogan never had it easy. A new biography paints a rich portrait of a darkly driven man who excelled amid great adversity

Excuse Me, but I Think Your Lapel Is Ringing

Wrist-watch phones, minute handsets woven into clothes, and more are already on sale in Asia. Expect them soon in the U.S. Plus: See some of them now in an accompanying online slideshow

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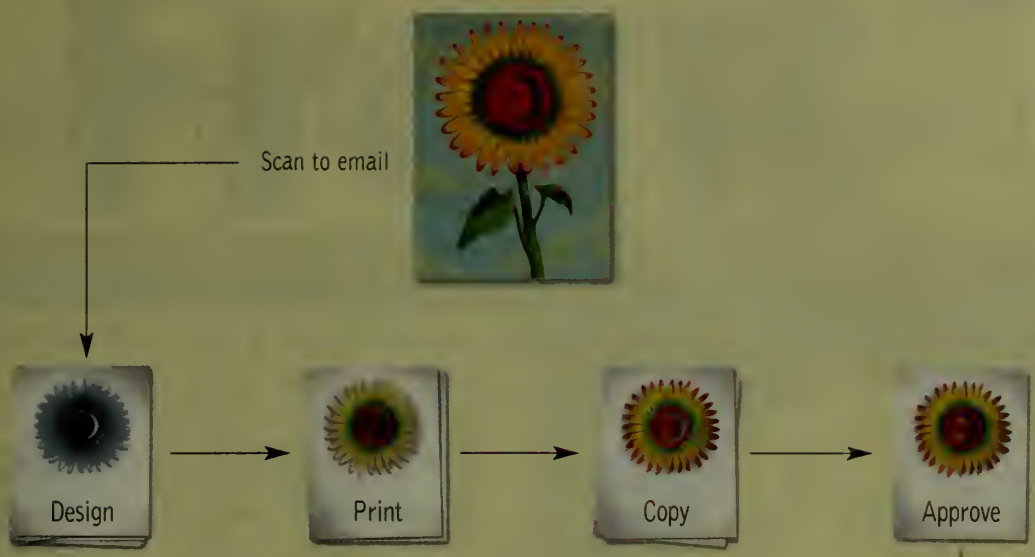

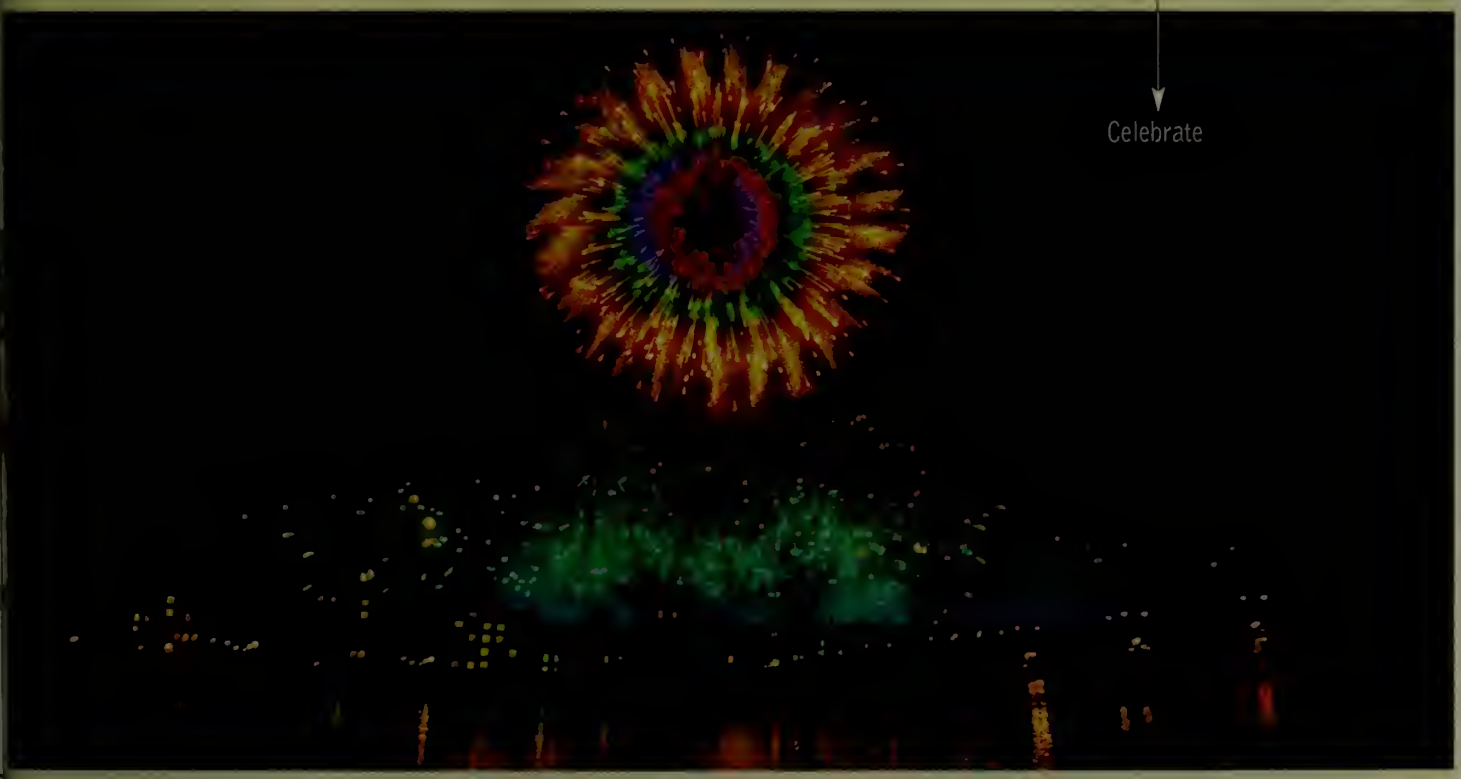

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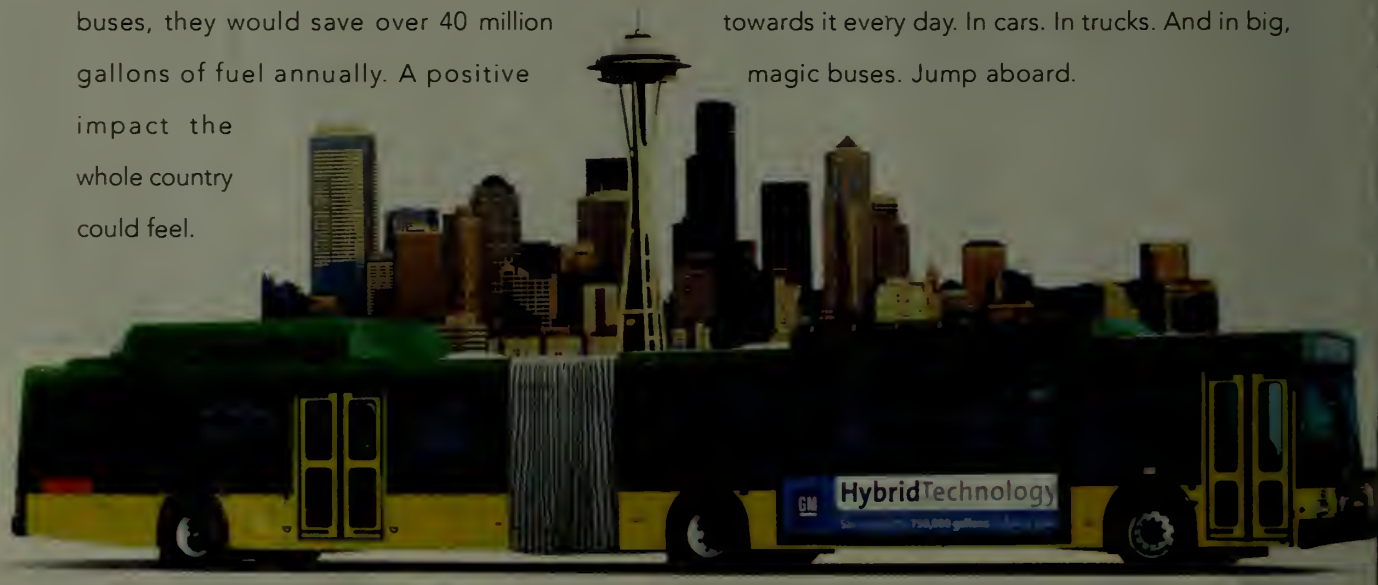

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JP Front

"I miss my old job terribly."

–Martha Stewart, at a meeting with shareholders of Martha Stewart Living Omnimedia

TED BY IRA SAGER

UBA WATCH

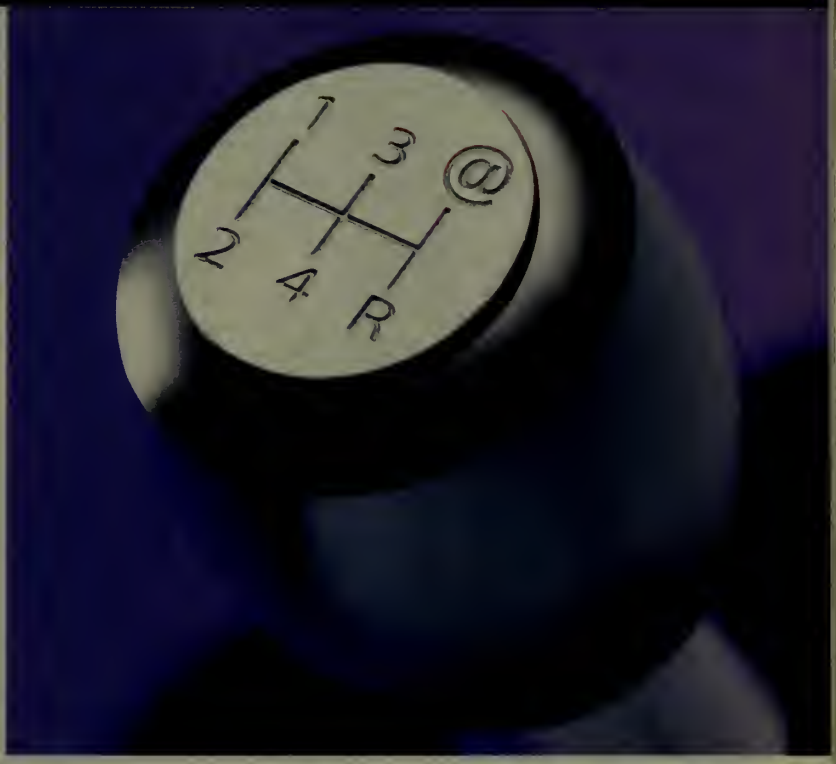
VILL TOUGHER 'RAVEL RULES 'LAY IN MIAMI?

'PUBLICANS typically appeal conservative, anti-Castro ıban-American voters in uth Florida by maintaining trict trade embargo ainst the Communist gime. But a ugh new lministration licy may be ırting President orge Bush with ıt politically ıportant group. Cuban-Ameri- ns visiting Cuba ve until July 1 get home. at's when new es kick in stricting visits once every ee years—and

STRO Florida voters e their island visits only to see immediate family. Previously, Cuban-Americans were allowed one visit a year. Last year, 120,000 made the trip, feds say. New rules even limit luggage to 44 pounds—to reduce the number of gifts visitors can bring.

Charter operators, the only U.S. airlines allowed to fly to Cuba, must get in touch with some 3,000 visitors and send them home to the U.S., in what frantic agents are calling "the Mariel airlift." Says Michael Zucatto, of **Cuba Travel Services:** "The Administration is messing with their families, and Cuban-Americans are not going to like that." If so, one of the GOP's big supporters in the closely contested state could be up for grabs.

–Paul Magnusson



WIRED WORLD

Click Once For Broadband

BELLSOUTH WILL BEGIN testing a broadband-on-demand service next month that will let customers jack up the speed of their Internet connection with a mouse click. *BusinessWeek* has learned that the new service, dubbed Turbo Button, will accelerate to a speed of 3 megabytes per second all BellSouth Web connections—even its poky dial-up access.

The new service would double BellSouth's fastest broadband connection. With about 80% of its 14 million homes wired for broadband, the telecom giant has the capacity to offer instant bursts of swift Web access. "If you are trying to download some music files or open a long PowerPoint attachment, you'll just hit a button and boost your speed," says Mark Feidler, who oversees marketing at BellSouth.

Zippy Web services are key revenue sources as the Baby Bells lose voice customers and as cable companies such as Comcast push deeper into high-speed Internet access. The company won't disclose how much it will charge, but dial-up customers will pay more than broadband users. Turbo Button should be available by yearend. For Web surfers with a need for speed, that could be manna from cyberspace. *–Brian Grow*

HE BIG PICTURE

EARCH FOR THE TOP As Google prepares for IPO, here's how it stacks up against rivals:

	GOOGLE	YAHOO!	MSN	AOL
ALITY OF SEARCH CHNOLOGY	1	2	3	4
ER TISFACTION	1	2	3	4
MBER OF GISTERED USERS	4	1	3	2
EADTH AND DEPTH CONTENT	4	1	3	2

Standard & Poor's Equity Research Services—a survey of 1,000 users ted during the week of Apr. 5 by InsightExpress

ed in order of 1 to 4, where 1 means best-positioned and 4 means worst

UP Front

STOCK OPTIONS

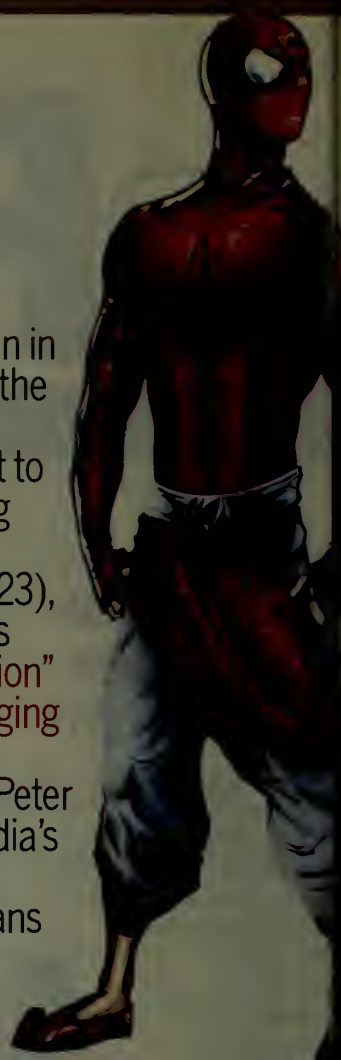
NOT MUCH LEFT ON THE PLATE

IS THE PARTY over for stock options? Of the companies in the **Standard & Poor** 500 that voluntarily began expensing options, three-fourths reduced grants to employees last year, says **Bear Stearns.** In all, the companies awarded $7.2 billion worth, down from $14.7 billion in 2002. While these are mostly nontech companies—Silicon Valley is still fighting expensing on Capitol Hill—Bear Stearns says mandatory expensing in 2005 means stingier grants will probably persist.

How much that hurts depends on your job title. Most surveys suggest that companies will, if forced to expense, cut from the bottom. New York consultant James Reda says he tells clients that no one below vice-president should receive options. So far, every client has taken his advice.

Meanwhile, a new study by **Watson Wyatt Worldwide** says that CEOs are actually taking the brunt of the option cuts. But don't worry: They're getting big stock awards to cushion the blow. Apparently, most boards believe the top dogs have a pretty low threshold of pain. *–Louis Lavelle*

TAILOR-MADE



WEB TALES Spider-Man in a *dhoti*? To cash in on the comic book hero's popularity in India (not to mention the upcoming Indian premiere of *Spider-Man 2* on July 23), Marvel Enterprises has licensed a "transcreation" of the classic web-slinging superhero for Indian audiences. Instead of Peter Parker, Spider-Man India's alter ego is Pavitr Prabhakar (*pavitr* means pure). He battles reinvented arch-nemesis Green Goblin, now known as Rakshasa, the name of a mythological Indian demon. *Spider-Man India*, written in Hindi, hits Indian stores mid-July. *–Seth Porg*

INN BUSINESS

PLEASE. I'D RATHER BOOK IT MYSELF

HOTEL CHAINS are finding that their push to book rooms directly from customers on the Web is paying off. **Hilton Hotels** says bookings from its sites jumped 30% in the first quarter, while sales through independent travel sites such as **Expedia.com** were up 10%.

Hotels have good reason to push their own sites: Online bookings will double, to $24 billion, by 2006—accounting for 27% of all revenue, says forecaster **PhoCusWright.** Travel sites keep 22% of the sale, vs. 10% for travel agents. If the customer books direct, the hotel pays no commission. *–Christopher Palmeri*

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UP Front

FACE TIME

WILLIAM GROSS

A BOND GURU WANTS A RATE HIKE

In more than 30 years as a money manager, William Gross has built PIMCO into the world's largest bond-fund company, with nearly $400 billion in assets. But with job growth accelerating and interest rates at 49-year lows, Gross is in the unusual position of advocating rate hikes that are likely to whack the value of his holdings.

Gross, 60, wants Federal Reserve Chairman Alan Greenspan to double the overnight lending rate, to 2%, by November. He fears low rates have caused asset bubbles in housing and commodities. "It has been a hell of a party," he says. "It's time for Greenspan to call a cab for all the speculators."

Gross has been taking steps to cover his assets, cutting the average maturity of his holdings, buying inflation-adjusting Treasury bonds, and putting cash into European government bonds. He got good news recently: New Jersey dropped Gross's bond unit from a lawsuit saying it allowed a large investor to make frequent trades. Now back to the rate push.

–Christopher Palmeri

PHONE BUZZ

UP NEXT: WEB CALLS OVER WI-FI

WITH THE PROLIFERATION of wireless networks in thousands of homes and public places such as **Starbucks** and **McDonald's,** finding a Wi-Fi hotspot to zip onto the Web is getting easier all the time. Now a growing number of telecom companies want to use those wireless networks for calls.

It's the next frontier for Internet phones, which use arcane voice-over Internet protocol (VoIP) technology. Today most only operate when tethered to a PC. But new offerings will include cordless "VoIP over Wi-Fi" phones for the home, and pricier models will use either wireless or cellular networks. Because calls made over the Net don't require per-minute charges, phone bills could be much lower.

The technology could put more pressure on phone companies to move away from decades-old approaches. **Motorola** will introduce a $300 phone by yearend that can begin a call using a wireless network and have it automatically rerouted to a cellular network if you move out of range of a Wi-Fi connection. Others, including **Cisco Systems,** are working on cordless phones that can be used in any home with a broadband connection and a Wi-Fi router. Intern phone pioneer **Vonage Holdings** plans to roll out su a device by Christmas.

Meanwhile, **IDT** is launching a pilot offering i Newark (N.J.) neighborho and will supply Wi-Fi acce for free. That means the phones work in homes tha don't have a broadband hookup or a wireless route of their own.

–Peter Burr

GENDER WATCH

IS YOUR COMPANY UP TO CODE?

CORPORATE GOVERNANCE may be improving, but business is being held to higher standards in another area, too: gender equality. On June 23, **Calvert Group,** which manages $10 billion in socially responsible funds, outlined actions that companies should take to promote gender equality.

Calvert Women's Principles covers everything from trying to source from female-owned suppliers to health issues.

Calvert will use the code in screening investments as well as in rating the 600-plus companies in its portfolio. **Dell** plans to use the code to measure its own progress in this area. Does the timing have anything to do with the newfound zeal for good behavior in the corporate suite? Calvert says no, but it must help that execs are under pressure these days.

–Diane Brady

THE STAT

100

The minimum amount, in millions of dollars, that the Defense Dept. spent from 1997 to 2003 on airplane tickets that went unused.

Data: General Accounting Office

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CELEBRATING 75

As part of its anniversary celebration, BusinessWeek *is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. In late September, 2004,* BusinessWeek *will publish a special commemorative issue on Innovation.*

The Creator Of McWorld

IN 1954, A MILK-SHAKE-MIXER salesman from Chicago took the red-eye to Southern California to call on two brothers whose little hamburger joint had become his best customer and the last hope for his faltering business. Raymond A. Kroc knew his five-and-dime and corner-drugstore customers were dying; what he couldn't figure out was why this upstart was ordering so many machines. Before he returned home, Kroc had a deal that not only would give his distributorship a new lease on life but would also change the American landscape and, for better or worse, diets in much of the world. Kroc, 52, became the national franchising agent for McDonald's.

Within a year, Kroc would open his first outlet in suburban Chicago, a red-and-white tiled box in Des Plaines, Ill., with a neon-yellow arch on either side and a simple menu of french fries, soft drinks, milk shakes (made in blenders sold exclusively by Kroc), and a 15¢ hamburger. By 1965—10 years after McDonald's Corp. was incorporated and four years after Kroc bought out the founding brothers—McDonald's would boast more than 700 sites. America was well on its way to becoming a fast-food nation. Kroc didn't stop there. He and his successors invaded one country after another, introducing McCapitalism to Russia in 1990 and to China two years later. By 2003, McDonald's had 31,100 outlets in 119 countries, fed 47 million people every day, and had sales of $17.1 billion.

Kroc did not invent the chain restaurant. And by the time brothers Richard and Maurice McDonald opened their prototype grill in San Bernardino, Calif., in 1948, Southern California was hopping with drive-ins. But it was Kroc—a high school dropout who once played piano in bordellos and speakeasies—who figured out how to turn burgers and fries into a mass-market empire. As postwar America moved to the suburbs, he foresaw the emergence of the ca culture. He insisted on standardization and spic-and-span stores, which meant a lot to a increasingly mobile population in search of something trustworthy wherever they went. fought to make McDonald's affordable—the price of its basic burger didn't rise till 1967—allowing even low-wage earners a chance to take the family out for dinner. Kroc brought mass-production techniques to personnel, to Jobs were simplified so that despite almost constant turnover among teenage crews, sto met Kroc's quick-serve standards.

> Ray Kroc saw how McDonald's could flourish in America's emerging car culture

Just as important was a franchisee-friendl structure. Partly this grew out of necessity: T cash-strapped entrepreneur had to rely on others to expan his reach. But Kroc also wagered he'd come out ahead by taking a 1.9% commission on franchisees' sales over 20 yea rather than hitting them with huge up-front fees.

Today, of course, McDonald's gets blamed for all sorts o ills: obesity, poorly paying McJobs, factory farms, a global dumbing-down of food, American hegemony. Kroc, who di in 1984, left a fortune that his third wife, Joan, passed on t the Salvation Army and National Public Radio. He never ti of seeing another pair of Golden Arches go up, and he nev felt the need to apologize for it, either. "We provide food th customers love, day after day after day. People just want m of it," Kroc said. As every salesman knows, you can't go wrong giving people what they want. ■

–Michael A

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"Thirty-five competitive seats out of 435 is a crime against democracy. Soviet elections were more competitive than this."

–Peter Intermaggio
New Haven

Our June 14 Special Report, "Does your vote matter?" provoked an outpouring of mail, pro and con, as well as many suggestions for improving the election system.

APATHY VS. INFORMATION

CONGRATULATIONS TO *BusinessWeek* for not only bringing these multiple issues to the public but also offering very realistic solutions. The irony seems to be that the very success of this country has led the majority to become indifferent to the election process as we engage only those day-to-day problems we feel we can influence.

Moreover, it may be that the average American cares significantly more than the government and the mainstream media presuppose, as the issues of primaries and gerrymandering are rarely spoken about. It's not that we are apathetic; it's simply that we are uninformed. If other media can follow *BusinessWeek*'s leadership, I am confident that the American people will rise to the challenge of this nonpartisan issue that is crucial to the survival of the American democracy we think we have.

–Bill Hory
Manhattan Beach, Calif.

HAVING MOVED TO Rhode Island I know firsthand that Presidential candidates will never campaign in this state. It is easily won by the Democrats, so my vote one way or the other will not matter.

I have voted for each party in the past, and I feel more apathetic this year than in any other. Yet I am more passionate about my choice this year than in any past election. Why doesn't Congress spend some quality time fixing the process rather than engaging in partisanship that solves nothing?

–James Morris
Lincoln, R

GERRYMANDERING HAS TO GO

FINALLY SOMEONE is talking about the theft of democracy represented by the extreme gerrymandering of U.S. House of Representatives districts. Thirty-five competitive seats out of 435 is a crime against democracy. Soviet elections were more competitive than this.

–Peter Intermaggio
New Haven, Co

THE ONLY HOPE is that the U.S. Supreme Court will recognize that the prime purpose of the census every

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years is to reapportion the states and that any reapportionment beyond the first one is unconstitutional. Furthermore, the court may find that gerrymandering as displayed in the map of Atlanta is against public policy, blatantly illegal, and requires that districts meet some mathematical criteria of compactness.

–Lawrence Briskin
Centerville, Ohio

YES, YOUR VOTE MATTERS

"DOES YOUR VOTE matter?" rests on a faulty premise. You argue that because most voters reside in "red" or "blue" states—states that we already know will vote Republican or Democratic in this year's Presidential race—they are effectively disenfranchised. How so? On Election Day, most Texans will vote for President Bush, while most New Yorkers will vote for Senator Kerry. How the votes from such "already decided" states will count less than those from swing states like Pennsylvania, Ohio, or Florida simply escapes me. Not long ago, the South was solidly Democratic and California was reliably Republican—the opposite of what we see today. As the world changes, voters' allegiances will shift once more.

You complain because Bush and Kerry spend so much time currying favor with swing voters in swing states. In fact, Bush and Kerry are each trying to do two things: 1) keep their base of supporters energized enough to cast their votes; and 2) persuade undecided voters to come their way. That's no different from what William McKinley did in 1896, Harry Truman did in 1948, or Ronald Reagan did in 1980. Nor is it any reason for an "already decided" Bush or Kerry voter anywhere in America to feel disenfranchised in the least.

–Lawrence J. Haas
Potomac, Md.

Editor's note: The writer was communications director for Vice-President Al Gore in 1998 and communications director at the White House Office of Management and Budget from 1994 to 1997.

YOU SHOULD BE ASHAMED of this contribution to national cynicism. Your article encourages voters from 33 states to avoid the polls because their state is already decided. But is it not the individual votes from these voters that decide these states? It is the voters themselves who make New York a "blue" state and Texas a "red" one. Telling these voters that their vote is immaterial is irresponsible.

–Joseph A. Mies
Duryea, Pa.

CORRECTIONS & CLARIFICATIONS

"A preemptive strike against cancer" (News: Analysis & Commentary, June 7) and the accompanying table referred to Merck & Co.'s Proscar (finasteride) as an anti-baldness drug. Proscar, approved for the treatment of enlarged prostates, was able in a large trial to reduce risk of prostate cancer by 25%. Procepia (also finasteride) is used to treat baldness.

"From Pain Therapeutics, a better painkiller?" (Inside Wall Street, June 14) should have said it expects to begin Phase III clinical trials by yearend (not file with the Food & Drug Administration for approval).

YOUR REPORTING emphasizes repeatedly red for Republican and blue for Democrat, yet in "How democracy in decline looks" proceeds to color the "particularly egregious" Democratic district in Atlanta in RED.

–Richard H. Kapp
Greenville, S.C.

THE PRESENT SYSTEM does not make one "voiceless" any more than your direct-voting remedy would. I am a Californian who will vote for Bush, though Bush will never win here. Yet I am not voiceless. I'm on the losing side of a fair election in which my vote was counted. Warts and all, it's more or less the same system we've had since the 1820s, and it works. Don't like it? Amend the Constitution. Can't muster the power to pass an amendment? That's democracy. Hamilton and the Federalists were wise, and I'm certain they would be proud of what we have today.

–Michael McKinney
Irvine, Calif.

HOW TO FIX A SKEWED SYSTEM

WINNER-TAKE-ALL laws grossly skew the outcome of the Electoral College. Maine and Nebraska do it differently. The electors in those states are chosen the same way as senators and members of Congress—only two at-large (which go to the statewide winner) and the rest by congressional district. If Florida had had this method in 2000 instead of all of its electors being at-large, Bush would have won only 14 of Florida's 25 electors, including the disputed district. Since he needed 24 to win, there would have been no fuss over hanging chads, butterfly ballots, or any other such ephemera. Gore would have won the election.

–Thomas J. Cassidy
Arlington, Va.

WHO IS THE 'TRULY BEST CANDIDA

I DO NOT KNOW how many times I voted "against" a candidate as oppose "for" a candidate. What is required completely different method of voti ranking all of the candidates instea voting for an individual. The candi with the highest cumulative ran wins. It is mathematically proven that method will produce a consensus of is actually the best candidate for the

This method would make me feel my vote mattered, and I could vote for truly best candidates instead of pick the lesser of two evils.

–Andres Ka
New Albany,

GIVE THIRD PARTIES A CHANCE

THANKS VERY MUCH for your critic timed review of the flaws in the Amer electoral system. Your list of reme lacked an important element, howe encouraging the development of t parties, and providing opportunities their meaningful participation in the e toral process. Reforms such as ins runoff voting and proportional repre tation, which make the playing field n accessible to parties besides the De crats and Republicans, would go a l way toward ameliorating the exce that the present duopoly perpetu The Center for Voting & Democ (www.fairvote.org) is just one resourc more information on these reforms.

–W. S. Mendler, C
Wayne County Green Party Comm
Honesdale

TRY TERM LIMITS FOR CONGRESS

THE OFFICE OF President as well as offices of governor in most states limited to two terms. Why not limit sena to two six-year terms and member Congress to three two-year terms? think: no more Robert Byrds, J Helmses, Strom Thurmonds—or J Kerrys, for that matter. No more ca politicians. Six to 12 years and you go h

Ray Spr
Fayetteville,

MEXICO AND CANADA WEIGH IN

THE U.S. IS THE ONLY major democ that requires its citizens to registe vote. In Britain, Canada, and even M co, it is the government's responsib These countries have independent e toral commissions, financed by the ernment, that have the responsibilit register all citizens and ensure that al izens vote under the same rules.

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software database that automatically reregisters all citizens who move from one electoral jurisdiction to another by obtaining driver's-license changes from all provinces on a monthly basis. Elections Canada was hired to assist Mexico's IFE (Instituto Federal Electoral) to create a national electoral database to begin the process of registering all of its citizens for federal elections.

–Jock Ferguson
San Miguel de Allende, Mexico

AS AN INTERESTED spectator, I believe that one important item is being overlooked as a factor in the declining number of voters who are casting ballots: The election process is so long—almost a full year—that voters lose interest. If the time frame were reduced to a more reasonable 60 to 90 days, considerable campaign cost savings would ensue, candidates would be more likely to focus on the election issues, and, perhaps just as important, incumbent officeholders could spend more time being productive in their elected positions.

–Terry Smith
Caledonia, Ont.

KUDOS FOR THE ELECTORAL COLLEGE

THE ELECTORAL COLLEGE works. Ronald Reagan won 49 states and a landslide. Clinton won in 1992, yet he got fewer votes than Michael Dukakis. So how did he win? Simple: the Electoral College. Since Clinton failed to get 50% of the vote, doesn't that make him a minority President? Do we need a runoff between first and second?

Since only half of eligible voters voted in 1992, doesn't that mean that only about 20% of eligible voters voted for the winner? So how could Clinton be a legitimate leader? Again, the Electoral College saved the day. A system without it could lead to division and multiple parties—and imagine the fractious problem of coalition governments.

–Tom English
Dallas

THREE OF THE FOUR times the winning President got fewer popular votes occurred during the 64-year period from 1824 to 1888. Since 1888—a span of 112 years—there has been only one such event (in 2000), while Democrats have elected 13 presidents and Republicans 15.

That's a pretty good balance. Conclusion: The Electoral College worked better in the 20th century than it did in the 19th. And it is working better as time goes by.

–James M. Caldwell
Louisville

THE PROBLEM WITH POWER STATES

RE "DEMOCRACY IN America: The election system is broken" (Editorials, June 14): Your proposal to abolish the Electoral College is absurd—the Founding Fathers got this one right.

Yes, Al Gore won the popular vote (50,999,897 to 50,456,002), but look closer than that. He won one state—California—by a count of 5,861,203 to 4,567,429, or 1.3 million votes. Throw in New York, which he won by 4,107,697 to 2,403,374, or 1.7 million votes, and he has a lead of 3 million votes before we even get to other states. If you look even closer, you find that the majority of the difference in those states (California and New York) boiled down to two cities, New York City and Los Angeles.

There is no way I want the values of two major cities to dictate national policy to the rest of the nation. If the Presidency were based solely on the popular vote, smaller states would have no reason to vote in Presidential elections. They would not be represented.

–Darel J. Coterel
Prattville, Ala.

THIS COUNTRY IS a republic. It is a federation of sovereign states. Despite what you may or may not have been taught by your professors in college, it is not a democracy. It was designed so that each state would have at least some say in electing a President. That is what a republic is.

"Unfiltered democracy" is most certainly mob rule, whether you like it or not. This is why this country wasn't designed to be an unfiltered democracy.

If the popular vote of the "mob" elected the President, New York and California would *always* elect a President for the whole country. This is precisely what this country wasn't intended to be.

–Doug Boehler
Bangor, Pa.

WHERE THE MEDIA LEAN

RE "THE LIBERAL MEDIA: It's no myth" (Economic Viewpoint, June 14): Robert J. Barro claims that the liberal media is no myth because "the Groseclose-Milyo study shows the media are skewed substantially to the left of the typical member of Congress."

Yet the cover story of the same issue, "Does your vote matter?" reports that one cannot assume that citizens share the opinions of their representatives because our electoral system is broken and corrupt. Barro would serve a maturing democracy better by assessing the quality of American journalism—indepen ence, courage, depth, diversity.

The "right"/"left" bias debate is n particularly useful, and in this instanc the justifying research is fundament ly flawed.

–Virginia Hamm
Portland, O

I READ PROFESSOR Barro's piece looki for hard evidence of the liberal bias sees. All was going well until the l paragraph, when he revealed that neith *The Wall Street Journal* nor talk radio we included. I never expected this respect professor of economics to deal from stacked deck.

The conservative voice is easily cessed in the media these days. An liberal is very much in vogue. Come do to the heartland, read, and listen.

–David B
Middleton, W

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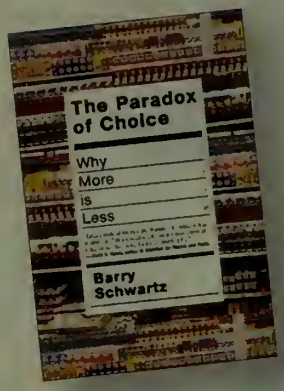

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Anxious Leisure

ON PARADISE DRIVE How We Live Now (and Always Have) in the Future Tense
By David Brooks; Simon & Schuster; 304pp; $25

Reading the first half of David Brooks's witty, lucid, and expansive take on the American middle class, *On Paradise Drive*, is like cruising around the suburbs with a younger, hipper Andy Rooney in an SUV, didja-ever-wondering at the sights. At some point in the last decade, Brooks writes, "the suburbs went quietly berserk. As if under the influence of some bizarre form of radiation, everything got huge.... The cars got huge... the houses got huge... the drinks at 7-Eleven got huge, as did the fry containers at McDonald's."

Along with the supersizing came a raft of peculiar preferences and preoccupations that Brooks suggests are predictable by Zip Code. For example, he claims people in coastal cities and what he calls "inner ring" suburbs around cities are largely ignorant of what makes vast numbers of Americans light up: NASCAR, the Left Behind book series, Pentecostalism, and the joys of vacationing in country-music mecca Branson, Mo. Inner-ring types, on the other hand, are "people who have developed views on beveled granite." Such people don't want to appear materialistic and vulgar, he notes, but their homes are packed with the toys they've worked their buns of steel off to afford—everything from heated bathroom floors to fridges with on-the-door nozzles that deliver "goat cheese and guacamole." The point of the idealized suburban life, he argues, is to pattern one's life after the game of golf: To live in neat, tidy, gadget-packed surroundings and work for par—a state of perfect balance in which anxiety and disorder are mastered.

I chuckled. I winced. I know the targets of Brooks's darts better than I'd like to admit. I've seen that change in the male gait that comes when shopping for a really good gas grill. I've had that conversation with an architect about beveled granite counter edges. The author's observations are laugh-out-loud funny. Ta Trader Joe's: Brooks calls the "morally elevated" grocery store of professional-zone suburb designed for "people wh wouldn't dream of buyin a whey-based protein ba that wasn't fully committed to campaign finance reform."

But then, about midw through the boo Andy climbs out the SUV (probab for a nice nosh a one of the "heav themed" suburb restaurants Broc collectively refer to as Chili's Oliv Garden Hard Ro Outback Cantina In pile social critics and political thinkers including Alexis de Tocqueville, Georg Santayana, and Ralph Waldo Emerson (Fortunately, the newer-model sport-utility attack wagons have plenty of cupholders.) Apparently some time ag these guys saw the roots of our preoccupation with getting the kids in the right schools, our 24/7 technology bent, and our generalized anxiety and future-mindedness. At this point, the book's enchantment fades. "It would b glorious to see mankind at leisure for once," wrote Henry David Thoreau in 1863, protesting the workaholism of American life. Hear! hear! we nod in t land of par—and as soon as I can affor that poolside outdoor kitchen complex shall elevate my feet and rejoice. But

> Stop and smell the roses. But be quick or be left behind

reformation never comes," sighs Brooks. The American consumer is "an anxious but unstoppable whirlwind."

From this point on, the author delivers an interesting chorus of voices, but somehow it's less thought-provoking than the standup routine that has come before. The second half of the book is filled with enthusiastic observations such as "the redeeming fact about American business is that it is a stimulant," and "Americans have always switched jobs with amazing speed," dutifully backed up by evidence the reader really doesn't require.

Ultimately, *On Paradise Drive* doesn't rise above pleasant beach-chair fare. Brooks offers a penetrating portrait of the obvious: Americans are hard-working, generally good-natured folks drowning in material goods. They ought to stop and smell the roses more, but they're constantly balancing a wistful desire to do so with the worries of a competitive, uneasy world. His notion that we are inheritors of the philosophy that limitless possibilities are open to us is true but by no means new.

On Paradise Drive boils down to an affirmation for the comfortable. It won't change your life, your outlook, or your travel plans. (If you weren't going to Branson before you read it, you won't go now.) Cockeyed optimists will give a rebel yell; worriers may drink their Big Gulps more quietly. And ideally, the legions of suburban remodelers will tone down their cocktail party chatter to try to sound less like war heroes for completing a renovation project without getting divorced. ■

–By Joan O'C. Hamilton

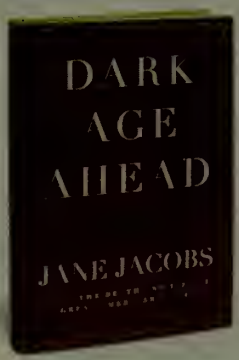
In Brief

Dire Predictions

DARK AGE AHEAD

By Jane Jacobs; Random House; 241pp; $23.95

In the most famous of humanity's Dark Ages, all of Europe lost contact with its classical past. The Romans' skills in agriculture, mining, and smelting—in fact, the very civilization they had wrought—were forgotten. Famine, disease, filth, and ignorance prevailed. Could such a fate overtake North America today?



It might, according to *Dark Age Ahead* by legendary urbanologist Jane Jacobs, author of *The Death and Life of Great American Cities.* Jacobs sees Americans "rushing headlong" into a period of "mass amnesia" marked by the loss of customs, rituals, and the fabric of culture. Never mind the Internet or even printing—both provide "a false sense of security" about a culture's permanence. Jacobs insists that values and skills are perpetuated via word of mouth and examples people set—and that Americans are at risk of failing to transmit civilization to their children.

Jacobs' alarm seems unwarranted by the evidence she sets forth. The U.S.-born but longtime Canada resident focuses on the erosion of five "pillars of culture" in the two countries, foremost among them family and community life. In higher education, she perceives a turning away from learning in favor of credentialism. She bemoans the loss of true scientific inquiry, arguing that scientists fail to ask the right questions and often follow each other's line of research blindly. Out-of-touch governments have stopped funding urban institutions, from mass transit to public health, she says. And professionals, such as accountants, betray the public trust by not policing themselves. But don't despair: Jacobs thinks we can save ourselves if we return to core values.

Jacobs' compendium of societal ills feels either familiar, as in her description of the disintegration of the nuclear family, or heavily overdrawn, as in her discussion of scientific inquiry. Even when you tote up all the problems she cites, it's difficult to see how they could produce a Dark Age. Jacobs, who has written compellingly about cities as engines of innovation and growth, here misses the mark. Her account is quirky and haphazard—and she rambles self-indulgently. For a thesis so promising, the author offers little that's new or persuasive. ■

–By Karen Pennar

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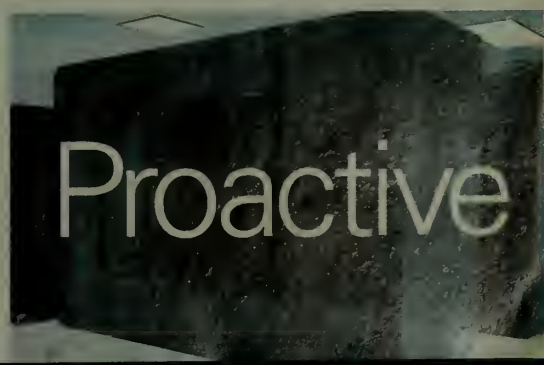

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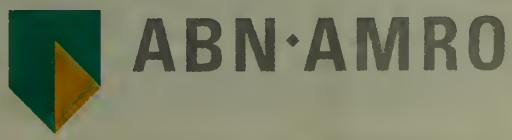

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BY STEPHEN H. WILDSTROM

What Intel's Opponents Are Up To

Intel may be inside the vast majority of the world's PCs, but competition is alive and well in the processor business, at least at the innovative edges of the market. Advanced Micro Devices has been giving Intel a run for its money in consumer desktops, and upstart Transmeta continues to nip at the low-power end of the laptop business. ¶ Intel's Pentium M processor remains king in the core market of thin-and-light business notebooks. But I looked at two non-Intel notebooks at opposite ends of the size and weight spectrum: an ultracompact Sharp Actius MM20 powered by a Transmeta Efficeon processor and a hefty eMachines M6809, run by an AMD Athlon 64.

Sharp chose Transmeta for its power-saving efficiency. The $1,499 Actius, which weighs just two pounds and is only .78 in. thick at its thickest point, is designed for mobility. It sells for $1,000 less than Sony's slightly thinner and lighter Vaio X505, its closest competitor. The Actius is intended to be a second computer—to the point of including a docking cradle that lets it sync with a desktop. Notebooks based on Transmeta's earlier Crusoe processor suffered from sluggish performance. The MM20, while no speed demon, is a lot snappier—perfectly adequate for light-duty use such as e-mail, Web browsing, some word processing. The keyboard is somewhat cramped but intelligently laid out and usable. The 10.4-in. display is very crisp, though some users may find the type too small, and the screen is a bit dim in the default power-saving "mobile" setting. Battery life of about three hours is acceptable. A $199 extended-life battery takes that to 9 hours but adds 9.6 oz. and a half-inch of thickness.

SHARP ACTIUS MM20

YET THE ACTIUS FALLS SHORT IN ONE KEY AREA of mobility: communications. Its wireless setup is one of the poorest I've seen, failing to connect to the Wi-Fi network in areas of my house where other laptops work without trouble. There is a jack for an Ethernet cable, but in the many places where dial-up is still the only option, you'll have to use a PC card modem, which is included but a bit of a nuisance. With improved communications capability, the MM20 would be ideal for the fleet-footed executive who needs more than a Pocket PC or a Palm but can get by with a minimal laptop.

At the other extreme, eMachines went with AMD for performance. Its $1,650 M6809 is one of the first to use a mobile version of the superfast Athlon 64. The M6809 is a screamer even though the processor won't reach its full potential until late this year, when Microsoft releases a version of Windows that takes advantage of the Athlon's ability to gobble data 64 bits at a time. (The Athlon 64 can run existing 32-bit Windows XP and applications, but they take a toll on performance.) Other specs, including a 80-gigabyte hard drive, 512 megabytes of memory, and a high-end ATI graphics adapter round out the M6809's performance profile. Its display is a 15.4-in. wide panel, ideal for movies, games or applications such as Adobe Photoshop.

All this power comes at a price. While eMachines, now a unit of Gateway, calls the M6809 "the Road Warrior," it's unlikely to stray far from home. Battery life is just a bit over two hours. At 1.6 in. thick and 14 in. wide, it's a briefcase-buster. And the 7.5-pound M6809 weighs nearly as much as four Actius MM20s. That said, it's a fine alternative to a desktop PC.

Rivals have forced the chip king to improve its processors

Despite relatively small market share, especially for Transmeta, Intel's rivals have driven important changes in the processor business. Transmeta pushed Intel to refocus its mobile-processor plans on long battery life. And the success of the Athlon 64 and its server-based sibling, the Opteron, forced Intel to reverse strategy and announce a 64-bit Pentium. It may be tough for competitors to crack the mainstream, but what they do on the fringes is important for the future of PC technology. ■

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BY ROBERT KUTTNER

Why the Economy Won't Boost Bush

The economic picture seems to be brightening, and just in time for President George W. Bush: three months of decent job growth; the stock market bouncing back; industrial production up smartly in May; oil price peaking and starting to subside. But even if these indicators keep improving, I suspect the average voter will continue to experience a soft economy. The latest (June 16, *USA Today*) polls show 58% of voters disapproving of Bush on economic issues. That number, his most negative ever on the economy, has steadily worsened despite months of improving economic news. Its unlikely to change much between now and November.

For starters, the job growth isn't translating into broad-based wage growth. Even after three months of good job creation, there is little pressure to raise wages. That's why the May core inflation rate—without volatile indicators like energy and food—is just 0.2%. There's no wage pressure.

The economy still has about 1.9 million fewer private-sector jobs than when Bush took office. So many discouraged workers have left the labor market that the participation rate remains well below what it was in 2001. Indeed, if it had remained constant, unemployment would be at 7.3% rather than the official 5.6%. When Bush's first tax cut was passed, the Administration projected that there would be about 139 million jobs by now. Instead, there are barely 132 million.

ONE STARTLING INDICATOR of the recovery's limited economic impact is the proportion of economic growth going to profits and to wages. Corporate profits have increased by more than 50% during this recovery, compared with just 0.8% in wage increases, according to Economic Policy Institute calculations based on Commerce Dept. statistics. In the eight previous recoveries, wages increased an average of 12.3%, and profits about 35%. This recovery's unprecedented skew explains the stock market rebound. It also explains why the average voter isn't sharing the prosperity and lacks confidence in the President despite the relatively good overall statistics. To add insult to injury, the typical consumer is facing higher gas prices and rising health-insurance costs.

Interest rates, likewise, will become more of a drag between now and November. Alan Greenspan, ordinarily Delphic in his pronouncements, has all but declared that the Federal Reserve will begin raising rates, probably at the June meeting of the Federal Open Market Committee. The only question is how much and how fast.

Many investors are soothing themselves with the mantra that the market has already priced the expected higher rates into stock prices; therefore there's little to worry about. But think again. Higher rates will slow the economy and harm the President's standing with ordinary voters in three respects. First, of course, they will dampen the recovery generally—that's the whole point. More narrowly (and more perversely), higher rates and softer labor markets will reduce worker bargaining power just when lower unemployment is generating a little pressure for shared gains. Federal Reserve Chairman William McChesney Martin's famous punch bowl is being taken away selectively.

Higher rates will also undercut the one element that has been sustaining consumption in the face of sluggish wage growth—the ubiquitous home equity loan. Consumers with adjustable home equity loans face higher monthly charges and past and future consumption. And homebuyers will pay more for new fixed-rate mortgages, which are already almost 200 basis points above their 2003 low, and rising. So while stock prices may escape serious correction and the overall job numbers are improving, the average voter is unlikely to feel the improvement in the pocketbook.

> Statistics show recovery, but most voters aren't sharing in it

There is a certain political justice in this. With core inflation and wage pressure still low, the Fed nonetheless is raising rates. Why? In part because of the immense structural budget deficits. Those deficits, of course, are the result of the collusion between President Bush and Chairman Greenspan, who uncharacteristically gave Bush cover to enact three irresponsibly huge tax cuts.

At the time, it looked as if Greenspan was shifting from prudent central banker to partisan Republican tax-cutter. Now, Greenspan is belatedly reverting back to Fed chairman, moving to cool the economy right on the eve of Bush's re-election. If this damages the economy, it will see both men right. ■

Robert Kuttner is *co-editor of* The American Prospect *and author of* Everything for Sale.

BY JAMES C. COOPER & KATHLEEN MADIGAN

Is the Wealth Effect Endangered Once Again?

No. Any bumps ahead should be mild for companies and consumers

U.S. ECONOMY What a roller-coaster ride it has been. Over the past five years, U.S. consumers and businesses made tons of money, then lost a sizable chunk of it, then slowly reclaimed their wealth stakes. For businesses, the rebuilding was helped by cost-cutting and debt refinancing. For consumers, rising home values and stock prices boosted net worth to new highs. Propelling most of this balance-sheet repair was the presence of the most accommodative financial conditions in decades.

Easy access to credit or equity financing greases the wheels of the U.S. economy. Homeownership, capital projects, car buying, and most inventory building would be extremely difficult if businesses and consumers could not raise capital or borrow. Now, though, with the Federal Reserve set to hike interest rates and the bond market wary of inflation, financial fundamentals are tightening. Will higher rates derail future wealth accumulation?

Probably not. Barring any miscalculations by the Fed's forecasters, the tightening of monetary policy will be a low affair (page 36). In turn, the cost of other financial instruments, from bonds to bank lending to equity financing, will adjust at a pace that should not disrupt this expansion's momentum or prevent companies and consumers from making more money.

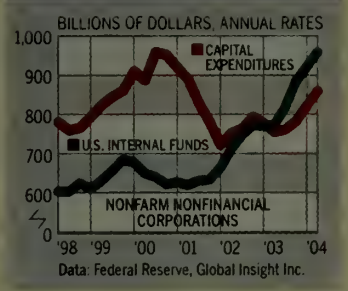
WHEN POLICYMAKERS SIT DOWN on June 29-30, they are expected to raise the federal funds rate by only a quarter point, to 1.25%. History shows that fed funds need to trade closer to 3% for Fed policy to be considered neutral, a case in which policy neither helps nor hinders economic growth. Even if policymakers hike rates by a quarter point at every meeting, the funds rate won't get to neutral until late next spring.

That gradualism, if well-communicated, should put the bond market at ease and keep long-term rates low, another plus for financial conditions. True, inflation is rising, but the advance will be muted as stronger U.S. pricing power is offset by global discounting. Low inflation will keep bond yields affordable at a time when intense competition among financial institutions is loosening lending standards.

Finally, the stock market should perk up once investors realize how well profits will perform over the next year. The recent sideways movement in most stock indexes may reflect noneconomic factors, such as the war in Iraq and its effect on oil supplies and worries over the presidential election. When the second-quarter earnings season begins soon, investors will focus again on the primary determinant of equity prices: future earnings.

Indeed, the performance of profits has been crucial in helping U.S. consumers and businesses rebuild their balance sheets. Leaving aside the debates over income disparity and the distribution of income between corporations and households, one fact is undeniable: This economy is generating a lot of wealth, whether by increased capital stock, equity gains, better home values, or bigger bank accounts.

PLENTY OF MONEY READY FOR SPENDING



Data: Federal Reserve, Global Insight Inc.

Just look at the latest financial data compiled by the Fed. In its first-quarter flow-of-funds survey, a look at how financial funds churn through the economy, the Fed reported that the net worth—total assets minus liabilities—of nonfarm, nonfinancial corporations and of households each hit a record high. In the first quarter, corporate wealth totaled $10.3 trillion, while consumers had $45.2 trillion. The two sectors have recouped the losses racked up after the stock market bubble popped and the recession hit earlier in this decade.

THE PAST FEW YEARS have been especially kind for Corporate America. Profits are rising at a double-digit pace, while tax-law changes have created generous depreciation allowances. Internally generated U.S. funds came in at an annual rate of nearly $1 trillion in the first quarter alone.

Companies are pulling in more cash than they are spending on equipment (chart). The "financing gap"—capital expenditures minus internal funds and inventory valuation adjustments—has been negative for a year. That's not because companies are shunning capital projects; expenditures rose 13.8% in the past year. It's because cash flow has surged 24.2%.

Moreover, businesses will probably keep spending big-time on capital goods for the rest of 2004, if only to take advantage of the large tax write-offs for business investment. These tax credits, part of Washington's

September 11 economic recovery plan, are set to expire at the end of this year. The accelerated depreciation schedules will allow U.S. business to cut their tax rates, generating even more internal funds.

With all that extra cash, it's no wonder the growth in corporate liabilities has slowed. Credit market debt is up only 3.7% in the year ended in the first quarter, much less than the 10% to 12% growth rates of the late 1990s. Much of the slowdown is due to better cash flow, but companies also took advantage of the extremely accommodative Fed policy and low bond yields to retire or refinance debt. Net interest payments for corporations fell in early 2003 and have shown only slight growth since last summer.

Although interest rates are rising, lending standards are falling. In a separate survey on bank lending, the Fed found that, on net, over 20% of domestic banks have eased standards for commercial loans for medium and large firms, the largest share since the early 1990s. So companies that need to borrow to buy new equipment or inventories will have better access to money.

FOR CONSUMERS, who hold the bulk of the nation's wealth (chart), greater prosperity has come from the rebound on Wall Street and the resilience in housing. Little in the outlook should change those uptrends.

Household direct holdings of corporate equities jumped 28% in the year ended in the first quarter, and mutual funds surged 39%. Owners' equity in real estate—the value of homes minus the mortgages outstanding—rose 8.2%. Stock portfolios are still down $3.7 trillion from their peak of early 2000, but that shortfall has be partially offset by the $2.3 trillion gain in real estate holdings. Moreover, with profits growth still looking good, equity prices have the potential to keep growing

Meanwhile, mortgage rates, at about 6.25% now, ha not hit the point where home buying is choked off. Bu rates have risen enoug so that the worries abo overheated housing demand may recede.

CONSUMER WEALTH IS AT A RECORD HIGH

Higher rates mean refinancings have slow but that's a plus for wealth. Homeowners see their residences' n value grow instead of cashing out some equi when refinancing. Consumer balance she will also benefit from continued gains in jobs and incomes as businesses hir new workers to meet increasing demand.

In fact, a major key to future wealth accumulation w be the balanced, self-sustaining expansion now in plac Absent any shocks on the pricing or geopolitical front the Fed has the room to raise rates in small steps. And while financial conditions will tighten, the gradual pac plus the economy's momentum, mean investors and borrowers, consumers and businesses alike should eas adjust to the new reality. ■

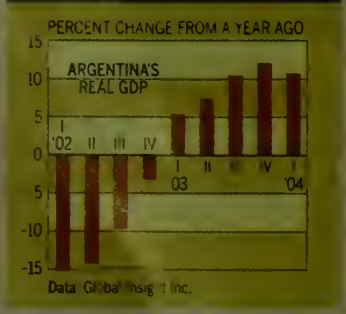
ARGENTINA

Investors Need a Little Reassuring

AFTER THREE QUARTERS of terrific growth, Argentina's economy is at a crossroads. The government must now spark more investment in order to keep the expansion going.

Fueled by a boom in exports, especially to China, and strong consumer spending, first-quarter real gross domestic product expanded by 11.2% from a year ago. However, growth is threatened by gas and electricity shortages, the result of scant investment during years of government-set price controls. A lack of energy is forcing work stoppages and rationing by industry. Meanwhile, rising wages are spurring inflation. In May prices rose 4.3% from a year ago.

THE GOOD TIMES COULD BE AT RISK



Authorities so far have turned a blind eye to a potential slowdown, preferring instead to spend an expected $2.6 billion tax windfall from the recent recovery on social programs and public works such as new gas pipelines. But these moves are not helping to produce jobs or foster a favorable investment climate. In the first quarter, the jobless rate fell by only one-tenth of a percentage point, to 14.4%.

To generate real job growth, President Néstor Kirchner must convince investors that the economy's newfound competitiveness won't be stamped out by interventionist policies. Since Argentina ended the peso's peg to the U.S. dollar in early 2001, the currency has dropped 75%, making Argentina more attractive outsiders. Foreigners, however, are slow to arrive. At home, banks are flush with cash and interest rates a at all-time lows. Yet, demand for loans is still far below what it was the start of 2001 because local businesses are afraid to take risks.

One way to ease doubts about the economy's long-term health would if Kirchner put an end to protracted haggling with foreign creditors over the restructuring of $100 billion in defaulted bonds. Although nobody expects a deal to be a cure-all, it wou provide renewed access to capital markets for corporations. More important, it would help Kirchner dispel fears that he's backtracking o the previous decade's economic reforms or that he is isolating Argentina from the world. ■

–By Joshua Goodr in Buenos A

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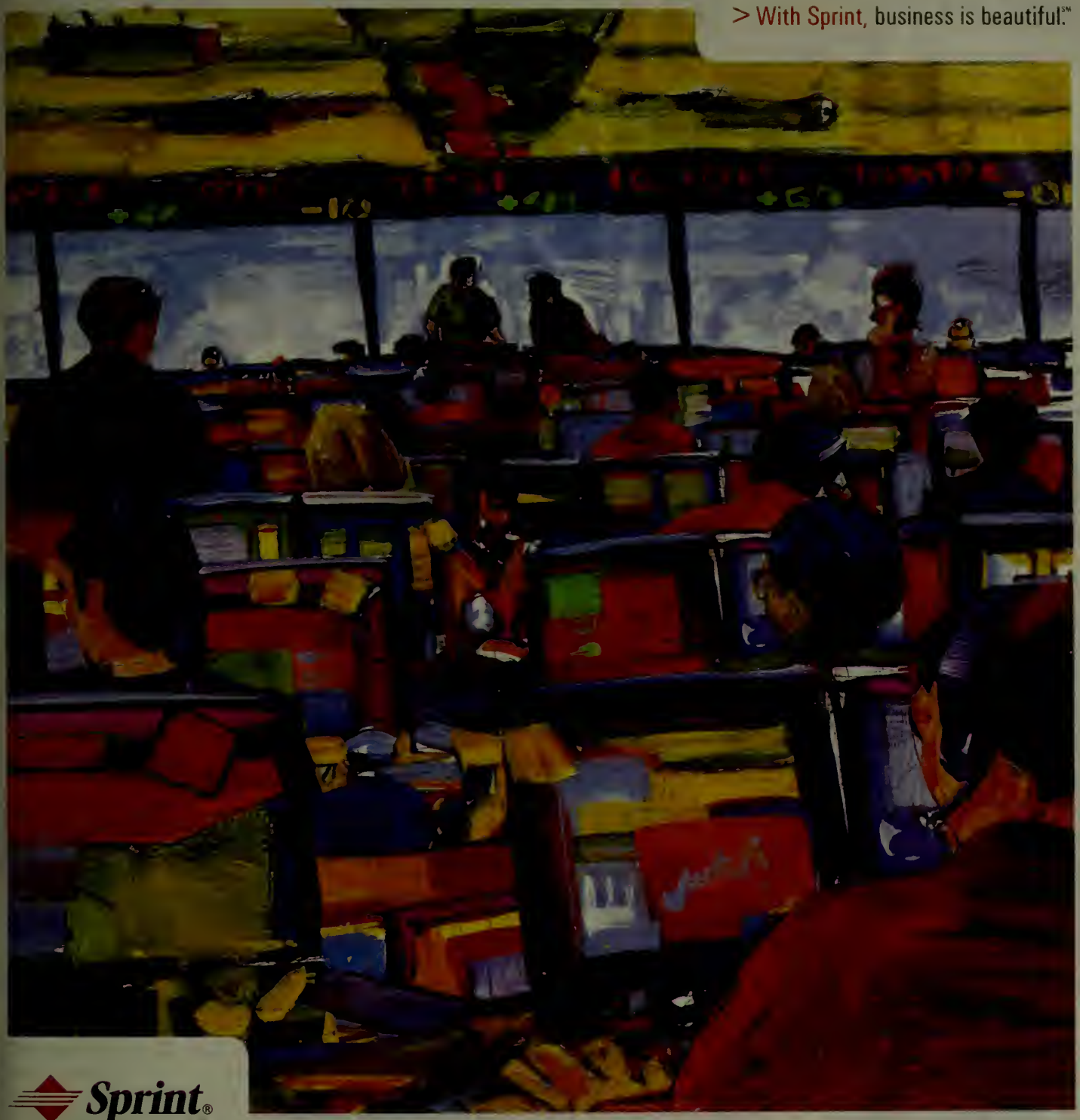

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THE ECONOMY

WHAT KEEPS GREENSPAN UP AT NIGHT

The Fed chairman must fend off the threat of inflation without stealing momentum from the recovery. Can he walk that fine line? BY RICH MILLE

As the Federal Reserve gets set to raise interest rates for the first time in four years, Chairman Alan Greenspan is sounding pretty confident. In testimony before the Senate Banking Committee on June 15, Greenspan said the U.S. looks to be on track for a lengthy economic upturn. "The economy is growing in a solid fashion," he said. "Inflationary pressures are not likely to be a serious concern in the period ahead."

Greenspan's best-case scenario is clear. He'll likely start off with a quarter-percentage-point increase in the federal funds rate, to 1¼%, at the Fed's June 29-30 meeting, then follow that up with as many bite-size, easily digestible hikes as needed. His aim is to gently wean the economy and the financial markets off their dependence on cheap money without either quashing the recovery or allowing inflation to reignite.

Still, the task ahead is a lot trickier than it looks. For one, the Fed cannot be sure if the recent surge in inflation is an isolated event or a return to the bad old days of rising prices. High unemployment rates suggest that there's still plenty of slack in the labor market, but a few more months of strong job growth could begin to eat that up. And the continued increase in home prices—up 7.3% over the past year—is making it harder to dismiss the possibility of a housing bubble that could burst and cause widespread damage if interest rates rise too sharply.

Then there are the biggest impond ables, productivity and terrorism. On t economic side, productivity is the k variable determining how fast the ecor my can grow. Yet no one has any id whether today's heady productiv growth—averaging 4.5% since the beg ning of 2001, close to the highest record for a three-year stretch—can sustained, or how far it may drop.

Uncertainty Factor

ON THE GEOPOLITICAL side, a ma terrorist strike in the U.S., or expand conflict in the Mideast, could char monetary policy calculations overnig Oil prices have already spiked on fe that terrorist attacks will disrupt suppl from Saudi Arabia.

Indeed, given all the things that co

ALSO IN THIS SECTION:

42 A close look at Arnold's California

46 Clinton's *My Life*: Readable? Reliable?

48 Wal-Mart: A culture shock may be coming

50 Why the major airlines need to be overhauled

go wrong, Greenspan remains wary and ready to change course quickly if events don't unfold as he expects. "Uncertainty is not just a pervasive feature of the monetary policy landscape," Greenspan told lawmakers on June 15. "It is the defining characteristic of that landscape."

What's at stake—as Greenspan and the Fed try to set monetary policy against that backdrop of uncertainty—is nothing less than the ability of the U.S. economy to move into a period of sustained expansion. If the fed funds rate can be gradually returned from today's 1% to more normal levels—say, 4% or so—without damaging the economy, it would be a tremendous accomplishment. It would mean that the U.S. had successfully weathered a stock market bust of epic proportions, unprecedented terrorist attacks, rampant corporate scandals, and war in the Middle East. The slow pace of rate increases would also keep the Fed out of politics in this fall's elections and set the U.S. up for another round of strong growth.

Such an outcome would cement Greenspan's legacy as one of the greatest central bankers of all time. He would bequeath his successor—whomever it may turn out to be (page 40)—a low-inflation, high-productivity economy. By contrast, if inflation should zoom out of control, or rising rates should disrupt the financial markets and the recovery, it would call into question Greenspan's unconventional approach to the technology-driven New Economy: letting the boom run as long as possible to stimulate growth and investment, quickly slashing rates to cushion the impact of the bust when it finally arrived, and then holding rates low to revive growth.

For now, both the economy and Greenspan's place in posterity are looking pretty good. The latest *BusinessWeek* survey of economic forecasters shows that they expect growth to average a solid 3.8% over the next year. Meanwhile, the inflation rate a year from now is expected to be only 2.2%, well within the usual definition of price stability. Moreover, Greenspan's task today is easier in some ways than it was in 1994, the last time the Fed had to unwind low interest rates. Inflation is lower, productivity growth is higher, and the financial markets seem better prepared for the coming rate hikes.

If Greenspan's go-slow, measured approach works, he will have burnished his reputation in a career that began with his appointment to the central bank in 1987 by President Ronald Reagan, and that will end in early 2006, when his term as a Fed board member expires. Greenspan, now 78, saw the economy through many rough spots, including the 1987 stock market crash, the 1990-91 recession, and the 1997 Asian financial crisis.

Greenspan's Dilemma

He's under pressure to raise rates because of...

INCIPIENT INFLATION

With prices of everything from gas to milk soaring, Fed officials have been surprised by the jump in inflation this year. They think the higher numbers will turn out to be temporary but are ready to raise interest rates aggressively if that isn't the case.

3.3

CORE INFLATION O PREVIOUS THREE MO AT ANNUAL RAT

PRODUCTIVITY WORRIES

Productivity has surged over past three years, pushing down labor costs and helping to contain inflation. But if those gains decelerate more sharply than expected, companies will have to boost prices in order to maintain profit margins.

4.5

AVERAGE ANNUAL PROD GROWTH OVER PRE THREE YEARS

FASTER JOB GROWTH

The labor market has finally taken off after several years of sluggishness. If companies keep hiring, the pool of available workers will shrink and employers may find themselves bidding up wages to get the talent and experience they need.

1.4

MILLIONS OF JOB CREATED OVER THE PREVIOUS YE

Prophet of Boom

BUT HIS CONTRIBUTION as a central banker will ultimately be defined by his handling of the technology boom in the late 1990s, the bust that followed, and the current period of uncertainty. Convinced that the economy had entered a new epoch of productivity-powered prosperity in the late '90s, Greenspan held back from aggressively raising interest rates as capital investment boomed and the eco omy roared ahead. In the process, countenanced a stock market bubble, e pecially in tech stocks, that later burst, b ginning a three-year slump.

To shelter the economy from the fa out, Greenspan then slashed rat sharply, avoiding any major financial co lapses and limiting the decline in gro domestic product to only 0.7 percenta points, a very shallow recession. Wh the recovery proved hesitant, Greensp went even further. Faced with what ev he admitted was the remote risk of a d flationary downturn in prices, the F chief last year cut short-term intere rates to a 46-year low of 1% and pro ised to keep them down for a conside able period.

Combined with sharp tax cu Greenspan's monetary strategy had its i tended effect. Over the past year, t economy has raced ahead at a 5% ra the stock market jumped 17%, and t

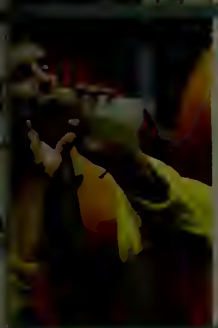
he can't go too fast because of...

BUBBLE TROUBLE

Thanks to cheap money, house prices have reached what even some Fed officials fear could be bubble territory. To prevent a sharp price decline that could hurt the economic recovery, Greenspan & Co. want to raise rates in measured steps.

7.3%

INCREASE IN SALE PRICE OF EXISTING HOMES OVER THE PREVIOUS YEAR

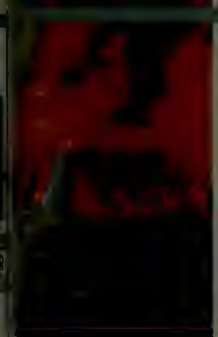


FINANCIAL FRAGILITIES

Fed officials fear a replay of 1994, when rising rates triggered financial problems. To try to head off "time bombs" that could go off as rates rise, they have gone out of their way to repeatedly signal that tighter credit is on the way.

-0.8%

CURRENT FED FUNDS RATE, ADJUSTED FOR INFLATION



WILD CARDS

Anything from a terrorist strike before the Presidential election to a dramatic slowdown of growth in China could leave the U.S. economy vulnerable. Greenspan has tried to anticipate such pitfalls and map out contingency plans.

?

Data: Bureau of Labor Statistics, National Association of Realtors, Federal Reserve, *BusinessWeek*

conomy generated 1.4 million new jobs ter a long drought. Compared with the termath of Japan's economic bust in the rly 1990s—which sent that country into decade-long tailspin—the American exrience seems positively benign.

Even the pickup in inflation does not em terribly threatening to the Fed—yet. ue, overall inflation has accelerated arply to an average annual rate of 5.5%, er the past three months, mainly from gher energy prices. However, core inflaon, not including energy or food, is runng at a 1.7% rate over the past year, mpared with a 1.6% rate a year earlier. hat helps explain why most Fed policyakers, including Greenspan and Fed overnor Donald L. Kohn, see the rise in ices as transitory, not the start of a eadily worsening inflation picture.

Moreover, if inflation is rising mainly cause companies have regained some icing power, Greenspan is willing to lerate it. Why? Because he knows that those price increases will eventually slow down as the lure of fat profits draws more competition into the marketplace. "My guess is that five years from now we'll look back at 2004 as another year of low inflation," Minneapolis Fed President Gary H. Stern told *BusinessWeek* on June 1. Adds Tom Hoenig, president of the Kansas City Fed, in an interview on June 4: "We still have an environment of relatively modest inflation."

That labor costs, a figure Greenspan monitors closely, remain under control is reassuring to the Fed chief. The latest figures from the Bureau of Labor Statistics show that unit labor costs are down by 0.8% over the past year, a testimony to strong productivity growth.

Fed officials also don't seem terribly worried about demand outrunning the economy's productive capacity soon. True, job growth has finally picked up. But surplus workers and ununused factory capacity still seem to abound, so inflation should be contained. Manufacturing capacity utilization is hovering at 76.4%—more than three percentage points below its long-run average. And with unemployment still stuck at 5.6%—even without including the people who have left the labor force since 2000 and stopped actively looking for jobs—there's enough spare labor to head off pressure for higher wages.

Moreover, Greenspan is encouraged that companies still have plenty of internal financial resources they can tap to expand capacity. The latest data from the Federal Reserve show corporate cash flow running ahead of capital investment. As a result, corporate liquid assets—things like cash and government securities—are up by over $100 billion over the past year.

Not everyone is so sanguine. The prevailing wisdom in the financial markets is that the Fed has already missed its chance to head off inflation. Pessimists point to the latest figures from the BLS, which show that core inflation has risen at a startling 3.3% rate over the past three months. As a result, they say, rising prices will force Greenspan to move more aggressively to hike interest rates than he would prefer. "The Fed hesitated too long," says Wall Street veteran Henry Kaufman. "There is inflationary creep in the pipeline." Traders seem to believe that the fed funds rate will move up from 1% today to 1.5% by August, and 2.3% by January, based on interest rate futures contracts on the Chicago Board of Trade. While still quite low by historical standards, such an increase in rates could be enough to puncture the housing market and take some of the wind out of economic growth.

Educated Guesses

FED OFFICIALS ADMIT that there's a lot they don't understand about the inflation process. Although Kohn doesn't see prices spiralling out of control, he told the National Economists Club in Washington on June 4 that he had been "surprised by the extent of the pickup in core inflation this year."

A potentially troubling factor is productivity. Fed policymakers did not accurately forecast just how robust it would be over the last three years, and no one, not

even Greenspan, seems to have a particularly good explanation why it's so strong. "Trying to predict the underlying trend growth rate of productivity is fraught with difficulty," outgoing Richmond Fed President J. Alfred Broaddus told *BusinessWeek* on June 7. Nevertheless, Greenspan remains optimistic about future productivity trends, and the best guess of many economists is that productivity growth will eventually settle in around 2.5% per year, a decent number by anyone's standards.

But if productivity growth proves as surprising on the downside as it was on the way up, then the Fed and the economy may be in for some trouble. Over the years, economists have had little luck anticipating future productivity gains. In fact, unexpected changes in productivity growth—including the sudden slowdown in productivity gains in the 1970s at a time when oil prices were also rising—count for some of the biggest miscalcu tions in economic forecasting.

This time, a sudden and unexpec tailing off in productivity could lead t burst of inflation as companies scram to raise prices to cover higher labor co Indeed, some forecasters are predict that productivity growth in the seco quarter could slow to a 1% pace or less

Moreover, the amount of excess cap ity in the economy is devilishly difficul measure, Fed officials admit. Some p cymakers, including Philadelphia F President Anthony M. Santomero, w der whether rapid technological char means there is less slack in the labor m ket and in factory capacity than there pears to be. In an interview on June Santomero suggested that a grow number of workers may simply be une ployable because they lack the right sk for the jobs available. In fact, a Philad phia Fed survey in April of regional m ufacturers found that more than 40% them reported having difficulties in fill job openings because applicants did have the required skills. Technological novation may also mean that some of existing factory capacity is outmoded a not available for use, Santomero said.

Insidious Inflation

PERHAPS THE TRICKIEST factor det mining the future path of inflation is pectations. Inflation is a self-feed process. If companies and workers convinced it will remain under control Greenspan believes, then the cent bank can afford to move at a much m measured pace in increasing rates in sponse to rising price pressures. But o companies and workers start anticipat rising prices, they act in ways that f the inflationary spiral. Companies will quicker to jack up prices, and workers aggressively press for higher wages make sure they don't fall behind. "I very important that we not allow an in tion process to get going," St. Louis F President William Poole said in an int view on June 7. "It tends to develop so momentum of its own, and it's expens to reverse."

That's why some Fed officials want central bank to junk its pledge of "me ured" rate hikes as soon as possible. T fear it's giving investors the impress the central bank won't do what it take keep inflation under wraps. Indeed, measured by the Treasury's inflation p tected securities, inflation expectati over the next five years have ri

Who Can Fill Greenspan's Shoes?

With the Fed chairman approaching the end of his career, the next President will appoint his successor. The leading candidates:

REPUBLICANS

MARTIN S. FELDSTEIN

An economic adviser to George Bush on the campaign trail, the Harvard professor is considered the front-runner. But he could face opposition from hard-line conservatives, who still fault him for his criticism of Reagan's big budget deficits in the early 1980s.

R. GLENN HUBBARD

Newly named dean of Columbia Business School, the well-respected ex-chairman of Bush's Council of Economic Advisers drafted the controversial dividend tax cut. But Hubbard is more versed in taxes and regulation than monetary policy.

JOHN B. TAYLOR

The former Stanford University professor has the experience and economic credentials to handle the Fed job. But he's a long shot: In his current post as Treasury Under Secretary for International Affairs, he hasn't impressed Wall Street, a key Fed constituency.

DEMOCRATS

ROBERT E. RUBIN

Given his success as Treasury Secretary under former President Bill Clinton, Rubin would top the list of John Kerry's Fed candidates. But associates doubt that the Citigroup exec would take the job; he may prefer instead to stay on Wall Street.

LAWRENCE H. SUMMERS

Now president of Harvard University, the former senior Clinton Administration official is a brilliant but at times abrasive economist. That has led some to question whether he has the temperament for the politically delicate job of Fed chairman.

STANLEY FISCHER

Having made his mark in Washington as a key policymaker at the International Monetary Fund during the Asian crisis, he now works with Rubin at Citigroup. But the former MIT economist may lack the political connections to land the job, unless more prominent contenders bow out.

harply, from 1.3% a year ago to nearly 5% now.

But from Greenspan's perspective, very reason to be more aggressive about ising rates seems to be balanced out by n equally compelling reason to go slow. or one, he doesn't want to disrupt the financial markets, as happened in similar eriods in the past. In 1994-95, the Fed oubled short-term rates to 6% in a year, ading several hedge funds to go belly up nd forcing Orange County, Calif., to file r bankruptcy as its investments went our. More recently, in 1999-2000, the ed boosted interest rates by 1¾ percentge points over ten months, only to slash tes the following year as the economy ent into recession.

The most delicate issue concerns the ousing market. While most Fed officials ave dismissed talk of a housing bubble, ome are beginning to give it more crence as housing prices continue to soar. ohn, who a year ago argued that rising ouse prices weren't a problem, now is t so sure. "The odds have risen that ese prices could be out of line with ndamentals," he said in a speech April.

What has got the attention of Kohn and others at the Fed is that the rise in house prices has far outstripped the increase in rents. Rather than renting, people are buying homes at inflated prices and gambling that the prices will continue to rise. One analysis suggests that house prices nationwide may be overvalued by more than 10%, even after taking account of current rock-bottom interest rates.

> "We seem to be on track, but... it's not a gimme putt."
>
> *–Alan Greenspan*

The implication is that an overly rapid increase in rates could puncture the housing bubble, causing a sharp decline in housing prices. That could hold down consumer spending and growth through the so-called wealth effect.

As Greenspan and the Fed wrestle with finding the right course for monetary policy, President George W. Bush has much riding on it as well. He is running neck and neck with Democratic candidate John Kerry in the polls, and is counting on a strong and growing economy to help him win reelection in November. Administration officials have already given the green light to tighter credit by the Fed, saying the economy can handle small increases in interest rates. But if the central bank had to raise rates aggressively, that would be a major concern. In 1988-89, the Fed raised interest rates more than three percentage points, to close to 10%, over a 13-month period. That helped set the stage for the recession the following year that cost Bush's father reelection.

No one expects the same to happen again. But as Greenspan noted on June 15: "We seem to be on track, but as us duffer golfers like to say, it's not a gimme putt." In an uncertain world, it's still important to remember that monetary policy is tricky and difficult even for the best of central bankers. ■

BusinessWeek online For Q&As with Federal Reserve Bank presidents, including William Poole of St. Louis, visit www.businessweek.com/magazine/extra.htm

CALIFORNIA

ARNOLD IS HITTING HIS MARKS

The guv has plugged budget holes. But is he pushing the problems into the future?

FROM HOLLYWOOD ACTION hero to Sacramento mover and shaker, Arnold Schwarzenegger has made the transition to politician look easy. Consider how he has handled California's longstanding fight with Indian tribes over tax-free gaming revenue. After months of battle, Governor Schwarzenegger won an agreement on June 21 that ensures five of the largest tribes will cough up 15% of their future slot-machine revenues to a badly depleted state budget. On top of that, they agreed to pay off a $1 billion bond that will help trim the $14 billion deficit. It's all part of what Schwarzenegger calls "a new battle plan for the state of California." At a signing ceremony with the tribes, Schwarzenegger proclaimed that "instead of divide and conquer, this is unite and conquer."

Scarcely eight months since winning a free-for-all recall election that booted former Governor Gray Davis from office, the one-time Terminator has energized a state capital that had been paralyzed for years. Campaigning as a tax-cutting friend to business, the 56-year-old Austrian-born Schwarzenegger has muscled through ballot initiatives that will restructure the state's debt with $15 billion in bonds and will force lawmakers to balance the budget. Using his charm—and the threat that he would take ballot initiatives directly to voters—the hugely popular celebrity pressured legislators to cut California's skyrocketing workers' compensation costs by overhauling medical coverage. Most surprising of all, Schwarzenegger submitted a budget to the legislature that eliminates this coming year's deficit and even leaves a $998 million surplus. Most expect it to be approved on July 1. Said Schwarzenegger in a recent press briefing: "Businesses are coming back to California, expa ing in California, and creating jo in California."

Well, maybe. But the Golden State a its popular new leader—known around t state capital as both Conan the Republic and the Governator—still face huge ch lenges. True, Schwarzenegger has don brilliant job of dealmaking in refinanc the huge debt he inherited from Davis a in balancing the state's budget for the u coming year. Problem is, those acco plishments could quickly unravel, since balanced the budget largely by borrowi and by delaying promised funding schools and local governments. Wha more, he's counting on savings from g

Governor Schwarzenegg
Off to a promising start, but ple

» His 2004-05 budget would close a $14 billion budget deficit and create a $998 million surplus by cutting programs and delaying spending. But his strategy relies on one-time deals that could leave the state headed for another budget crisis.

» Five of California's largest Indian tribes have agreed to share casino revenues with the state. The tribes will also pay off a $1 billion bond over 18 years to help reduce debt. A Nover ballot initiative, though, could overturn the

» State legislators voted to revamp the co workers' comp system. But business lead skeptical that the new plan will cut rates ar near the 25% that Schwarzenegger predic

» California voters passed a Schwarzene backed ballot initiative to refinance $15 b

nment streamlining that he hasn't t accomplished.

That's why critics see most of chwarzenegger's hard work as little ore than budgetary patchwork. A fresh eficit of nearly $8 billion is projected r the fiscal year starting in mid-2005 the state Legislative Analyst's Office California is forced to repay prior ans. On top of that, California will have restore $2 billion in suspended edu- tion outlays and an additional $1.3 bil- n to local governments. "It's clear sail- g now, but there's a storm out there 2005 and 2006," says Pacific Invest- ent Management Co. bond guru illiam H. Gross.

CAN WE TALK? Visitors get to swing his Conan sword

to do

left over from his predecessor's stration. But critics maintain the refinancing pushes debt repayment into the future.

e Schwarzenegger focuses on state finances, te's energy problems are going largely essed. California still faces a shortage of es and power plants, leaving it vulnerable g gas prices and rolling blackouts.

What's more, as Schwarzenegger expends his seemingly limitless political capital on state finances, other looming issues are going largely unaddressed. The state, which suffered through rolling blackouts in 2001, is again perilously low on electricity (page 44). Other states, which offer lower taxes and fewer environmental regulations, continue to lure businesses away from California. Indeed, California is the second-costliest state in which to do business, behind Hawaii, according to the Milken Institute, a nonprofit think tank.

Businesses are still finding good reasons to leave

Then there's the economy. The state's once superheated job market now trails the nation in jobs created. In the past, California tended to garner about 11% of all jobs created nationwide, according to a University of California at Los Angeles study. Yet in March and April, the state created only 5% of the country's 700,000 new jobs. Although that could soon change, a return to the go-go years of the late '90s appears unlikely. The UCLA study projects job growth in the state for 2005 at just 1.9%, a big improvement over the 0.8% expected this year but nowhere near the 3.6% growth seen at the end of the last decade. But the news isn't all bad. Personal income growth is projected to grow by 5.2% to 5.6%. That is slightly ahead of the national average and will provide much needed tax revenue.

THE GREAT CONCILIATOR

AS THE GOVERNOR waits for robust economic growth to replenish the state's coffers beyond 2005, he's using his special brand of high-voltage charm to win over Sacramento's Democratic-controlled legislature. In a town where Davis often warred with leaders of his own party, Schwarzenegger has become the great conciliator. Visitors to his office at the Capitol get to swing the sword from his Conan films and meet with Schwarzenegger pals Danny DeVito, Clint Eastwood, and Rob Lowe, who sometimes sit in on meetings. Often, he strikes deals with legislative leaders at the presidential suite at the Hyatt Regency, where he lives when he's away from Los Angeles, or in a smoking tent pitched on the Astroturf patio outside his office, where the governor likes to puff on cigars. "He has vigor, he has charisma, and he's committed to making this state work right again," says former Assembly Speaker Herb J. Wesson Jr., a Democrat who negotiated the workers' comp deal.

All well and good. But charisma only goes so far in a state where business still finds plenty of good reasons for leaving. On July 1, California will become the first state in the nation to mandate "family leave" for all workers, including fathers. And later this year, if it isn't overturned by a business-sponsored ballot initiative in November, businesses with 200 employees or more would be required to provide state-approved health-care plans for their employees—a requirement that business groups estimate would cost $7 billion.

"SO DARN EXPENSIVE"

BUT THE BIGGEST BUSINESS beef is with a workers' compensation package that doesn't seem to save money the way Schwarzenegger had hoped. The legislative fix was designed to reduce workers' compensation costs, which have tripled for some companies in recent years, by establishing HMO-like networks of insurer-approved doctors. The rules also provide incentives for getting workers quickly back on the job. Schwarzenegger figures the changes should cut premiums by 25% to 30%. But insurers, including the state insurance commissioner, figure the savings at far less than that. "What the governor and legislature passed were just words," says Stanley R. Zax, chairman of Zenith National Insurance Corp., the state's sixth-largest insurer. It says it will cut rates just 10% starting in July.

That makes Arnold's job all the tougher. Although the governor has made calls to businesses thinking of blowing town—he sweet-talked Genentech Inc. into expanding its Vacaville plant and got Virgin Atlantic Airways Ltd. to put a new facility in San Francisco—other companies are heading out. Amy's Kitchen Inc., a maker of organic foods that is considering moving a third of its 750 workers to Oregon, got a call from Schwarzenegger asking the company to stay put. "We like it here in California, but we're on the fence because it's so darn expensive here," says cofounder Andy Berliner.

In Sacramento, Schwarzenegger can rely on a combination of clout and Hollywood charm to help push his agenda. With the statewide Field Poll estimating

that 65% of California voters approve of the job he's doing—higher than the 60% Ronald Reagan got in 1969—he isn't afraid to go "over the heads of the legislature," as he said the day after his election. When the workers' comp bill stalled in April, he headed to a local Costco to help sign up voters for a ballot initiative to roll back rates. To help fund the initiative, Schwarzenegger's political action committee, the California Recovery Team, gave more than $1 million. Earlier, the group funded his campaign to pass the $15 billion bond deal.

Everyone, of course, loves hanging with a movie star. And Arnold plays his role to the hilt. To promote tourism, he recently spoke to a group of tr agents—preceded by a stunt dou zooming through the audience on a r torcycle and dressed like a leather-jac clad Terminator. It's great theater. the show's not over, and the Gol State needs a big second act. ■

–By Ronald Grover in Sacramento
Christopher Palmeri in Los Ang

ELECTRICITY

For California, 'A Rosary Bead Summer'

Tech execs were in for a serious electric shock. With billions of dollars invested in plants that require a steady flow of juice, the members of the Silicon Valley Manufacturing Group were eager for an update on California's power situation. So they gathered May 27 at the headquarters of Cisco Systems Inc. in San Jose to hear from Federal Energy Regulatory Commission Chairman Patrick H. Wood III. It wasn't pretty. California, Wood said, is "skating on the edge" of another power crisis. Tight electricity supplies, he added, will make this "a rosary bead summer."

Four years after an energy crisis caused blackouts, soaring power prices, and the bankruptcy of the state's largest utility, California finds itself in an electricity hole once again. New power-plant construction has slowed, older plants have been shut down, and electricity demand has begun to accelerate along with the economic recovery. Another factor: Conservation efforts that sharply cut demand during the crisis have waned. The situation prompted the California Energy Commission on June 3 to predict that, in the event of a severe heat wave, the state's power reserves could fall below 5%—a third of what regulators recommend. "There will be emergencies," says Stephen Conant, an analyst at consulting firm Energy Security Analysis Inc.

That could be bad news for Governor Arnold Schwarzenegger, who hardly needs rolling blackouts as he ramps up efforts to retain and attract spooked businesses. The state energy commission says power consumption this summer will run about 3.7% above 2003—and that's assuming normal weather.

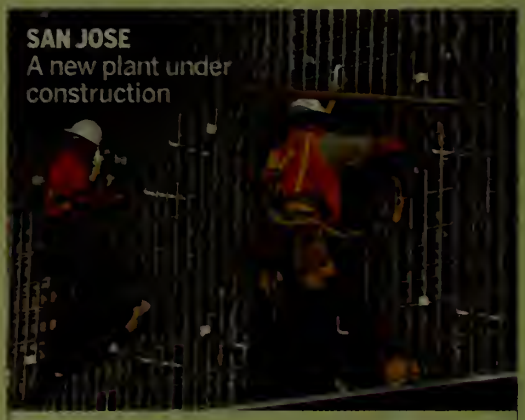
Problem is, supply isn't keeping up despite efforts to speed new-plant construction. Since 1999, state regulators have approved 19,000 megawatts' worth of new-plant construction, a 35% capacity hike. But following the 2000-2001 power crisis—in which a poorly conceived deregulation and alleged market manipulation by energy traders combined to send wholesale power prices spiking from $30 to $275 per megawatt/hour—federal authorities imposed price controls. Prices soon fell to around $40 per megawatt/hour, though they are now around $70. As a result, about a third of the planned new-plant capacity was put on hold since the anticipated returns were no longer enough.

At the same time, the sky-high cost of natural gas has made a number of older plants too costly to run, operators say. And because of low snowfall last winter, hydroelectric supplies from the Pacific Northwest are below normal. All told, supply is flat with 2003, at 60,700 megawatts.

A battle over continued efforts to deregulate is also partly to blame. Legislators are considering a bill that would allow large customers to buy power from independent power providers rather than utilities. But utilities and consumer activists want to limit the ability of those customers to abandon the utilities, fearing that their departures will raise prices for everyone else. Independent producers say that until the issue is resolved, they can't get the commitments for long-term contracts they need to help finance new plants. "We're in ideological gridlock," says Michael Florio, an attorney for The Utility Reform Network, a consumer group. "It's the typical California mess."

How bad will things get this summer? To keep the lights on, the state could institute new conservation measures and restart mothballed plants. But clearly a long-term solution is needed. California Public Utilities Commission President Michael R. Peevey is speeding approval of new plants from in-state utilities Sempra Energy and Edison International. The transmission infrastructure will be upgraded, too. And Schwarzenegger, now consumed by California's huge budget gap, is expected to focus more attention on energy if the new budget is passed on July 1. His predecessor lost his job in no small part thanks to the state's energy crisis. Arnie will have to move fast, lest he wind up starring in *California Blackout: The Sequel.* ■

–By Christopher Palmeri in Los Angeles



SAN JOSE A new plant under construction

Power Crunch

Why California could face another summer of rolling blackouts:

TIGHT SUPPLIES New-plant construction has slowed, and supplies of hydroelectric power from the Northwest are low

RISING DEMAND A strong economy has boosted the state's appetite for energy, while conservation efforts have waned

POLITICAL GRIDLOCK As politicians debate a bill that would allow industrial users to shop around for power, power-plant construction may be stalling

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COMMENTARY

BY CIRO SCOTTI

Messy Life, Messy Memoir

The Clinton book presents a story reeled off, not realized or adequately analyze

FOR AMERICANS OF every political stripe, the national drama that is Bill Clinton remains endlessly fascinating—a story still looking for an ending. And so we stay glued. Yet no American seems quite as fascinated by the Man from Hope as the Man himself. ¶ How else to explain *My Life*, a 957-page memoir that leaves almost no pebble unturned in the 57-year existence of William Jefferson Clinton. The trouble is, many of the most interesting stones are flipped over and then too quickly flipped back. How the crucial combo of James Carville and Paul Begala came to join his Presidential campaign, for example, is dealt with in a paragraph. Other moments that are about as compelling as an Arkansas gravel pit are relentlessly examined and cataloged. Does anyone really care that on Apr. 29, 1994, Clinton hosted Native American and Native Alaskan leaders on the South Lawn of the White House?

No matter. All the uninhaled pot at Oxford won't stop *My Life* from becoming a blockbuster. The reselling of this President has been a brilliant mix of hype, buzz, and tease. From the $10 million contract coughed up by publisher Alfred A. Knopf, to the chronically late Clinton's deadline scramble, to his soulful and down-homey interview on *60 Minutes*, Bill has been playing us like a country fiddle. Again.

After all the ink and hyperbole, though, the prospective reader must confront three simple questions: Should I buy this book? If I do, can I believe what it says? And will I learn anything new about Bill Clinton?

Starting in reverse order, the answer to the last question is a resounding yes. Unless you are a Streisand-style Bill-aholic—and we all know a few of them—*My Life* will try your patience. But from the parallel lives that Clinton frequently mentions, there slowly emerges one complex, compassionate, scarred, sometimes bitter, often maudlin, always political man who loves his kid, his kin, his compatriots, his country, and himself.

Whether Clinton recognized the dual life that he was leading when he was President is unclear. But he surely does now. On one track was the dogged, wonkish work life of the best liv American retail politician in the past half-century. That Clin with his inquisitive intellect, is on display as he recounts h shortly before his first inauguration, he sat down with a ro ful of advisers—Bob Rubin, Laura Tyson, Larry Summers, Al Gore among them—to hammer out an economic policy t would best boost productivity, growth, and employment. On campaign trail, he had promised a middle-class tax cut—bu listens, argues, and processes. In the end, he sides with deficit hawks, abandons the tax cut, and signs on to a mo stimulus package. It's hard to imagine that sort of healthy bate in the Bush White House, where ideology often tru discourse and the Chief is famously incurious.

On the other hand, it's equally hard to imagine the curr President or most previous occupants of Oval Office living the life that runs on C ton's other track. The Gennifer Flow Whitewater, Paula Jones, Monica Lewin Kathleen Willey, Ken Starr life that seem out-of-control and tawdry. That Bill over-the-top yet altogether recognizabl many peers of the "first baby-boom Pr dent...carrying more baggage than ocean liner," as Clinton describes himsel

Candor of that kind comes in rand bursts in *My Life*, and it is at such points t Clinton reveals himself—rather than in passages to which those seeking titillat will turn. Writing of the killing fields Rwanda, where in the early months of 19 some 800,000 people were murdered i gruesome frenzy, he concedes: "We were preoccupied with Bosnia, with the mem of Somalia just six months old, and with position in Congress to military deployme in faraway places that were not vital to the national intere that neither I nor anyone on my foreign policy team adequa ly focused on sending troops to stop the slaughter." How's t for flat-out honesty about a serious failure?

The juxtaposition of Clinton's two lives is never starker th in June, 1994, when he and Hillary go to Europe for the 50 anniversary of D-day. They meet the Pope, chat with John M jor at Chequers, dine with Queen Elizabeth and the royal fa ily on their yacht, walk Utah Beach with American vets, and taken on a midnight tour of the "new Louvre" by French Pr ident François Mitterrand and the architect I.M. Pei.

Back home, Whitewater is waiting. Clinton signs a new dependent-counsel law that in short order leads to the firing Robert Fiske, the first Whitewater special prosecutor, and

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appointment of Ken Starr. Clinton calls his original request for an independent counsel "the worst presidential decision I ever made." But he repeatedly blames Starr for politically motivated misconduct and a brazen abuse of power that ruins lives and finances.

Clinton is more subtly critical of the press—especially *The Washington Post*—for overtly negative coverage and for egging on the multiple investigations that hound him. He takes some comfort in the notion that it's not all personal, that he just happened into office during a new heyday of attack journalism.

Snarling Dogs

YEARS OF DEALING WITH an abusive, alcoholic stepfather and then putting on a happy face outside the home enabled him to compartmentalize, Clinton writes, to focus on the business of the Presidency while the dogs of the Right snarled outside his door. But after he confesses his relationship with Lewinsky to Hillary and they go off to Martha's Vineyard on vacation, he sets a frank yet disturbing scene: "I spent the first couple of days alternating between begging for forgiveness and planning the strikes on al Qaeda." A distraught husband sleeping on the couch hardly seems in the right frame of mind to think clearly about going after Osama. But Clinton never stops to ponder for long enough the true toll his private life takes on his public duties.

A hurried sprawl that could have been a masterly work

Like Clinton himself, *My Life* sometimes entertains, sometimes enlightens, and frequently exasperates. One can only presume that, given time, Clinton's well-regarded editor, Robert Gottlieb, could have carved a masterly work out of what is an encyclopedic but insufficiently analytic sprawl. And it's hard not to lament what the Clinton Presidency itself might have accomplished with tighter planning, structure, and editing.

Still, the $35 that *My Life* costs will get you only three summer-movie tickets and a large popcorn in New York. For the same money, you can get a seat at the wildly careening, predictably uneven Clinton Show, the first reality-TV Presidency—and likely the last. ■

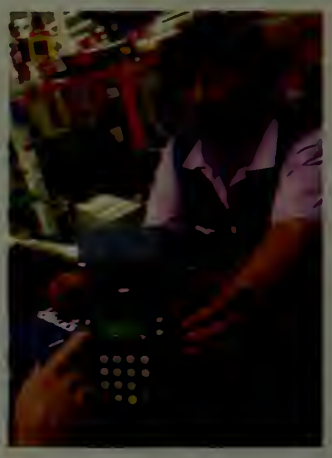
LAWSUITS

A WAL-MART SETTLEMENT: WHAT IT MIGHT LOOK LIKE

Damages for sex bias would be just the start. After that could come an entire change of cultur

IF THE OUTCOME OF DISCRIMINATION lawsuits at other major companies is any guide, Wal-Mart Stores Inc. could be facing a cultural revolution. The retailing behemoth will feel intense pressure to settle what became the nation's largest sex-discrimination class action ever on June 21. But any settlement would probably require dramatic changes in how Wal-Mart operates and would open its insular culture to scrutiny like never before.

Barring a victory on appeal to overturn the court decision, Wal-Mart will either proceed to trial or settle a case that covers up to 1.6 million current and former female employees. Most legal experts bet on the latter. Based on past discrimination accords and the goals of the plaintiffs' lawyers in Wal-Mart's case, the outlines of a settlement are fairly clear.



PAY GAP Closing it will be costly

Billions of dollars in back pay and punitive damages would be just the start for this $256 billion Goliath. For a company that prides itself on a fast-moving, entrepreneurial culture, the demand for an outside monitor and court supervision that could last as long as a decade would be the most troubling. Such terms would be similar to those in discrimination settlements at Coca-Cola, Lucky Stores, and State Farm Insurance. Wal-Mart won't comment on any settlement talks.

What's more, a court-appointed monitor could have the ability to review Wal-Mart's pay and promotion records and to audit compliance. Such an overseer "is completely nonnegotiable," says Brad Seligman of the Impact Fund, one of the lawyers representing t women in the case. Wal-Mart spok woman Mona Williams says it "wo be happy to cooperate" with an in pendent monitor, depending on scope of its involvement.

OBJECTIVE CRITERIA

ALTHOUGH WAL-MART has altered way it posts management jobs and p employees since the suit was filed in 20 the company may face demands for m change. Plaintiffs' lawyers will insist objective criteria that can be used to ev uate job performance a promotions—somethi that's been lacking. T company says it has cently brought in the H Group consultancy to vamp its job criteria.

As in other big d crimination cases, W Mart may have to ag to goals for boosti women in manageme Clear-cut objectives a timetables have work well at Salomon Sm Barney, which has upp the women in its brokerage ranks sir settling a sex-discrimination case 1997, says lawyer Linda D. Friedm who represented women in that suit. T company also improved training a mentoring and created an office of div sity, one step already taken by Wal-Ma "You can really reform a company" w such settlements, she says. Wal-M would also be pressured to close t male-female pay gap—at a cost of at le $500 million, say plaintiffs' lawyers.

Would such a deal bog Wal-M down in bureaucracy or make its e ployment practices as enviable as its te or its logistics? Hard to say. But the tailer is bound to find out. ■

–By Wendy Zellner in Dal

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COMMENTARY

BY WENDY ZELLNER

Big Airlines: Not Much Runway Left

United and the other major carriers must remake themselves—or go down tryin

FOR THE NATION'S biggest airlines, the day of reckoning is at hand. And if they didn't already know it, they should now. With the rejection on June 17 of United Airlines Inc.'s second attempt to get $1.6 billion in federal loan guarantees, the Air Transportation Stabilization Board has made it clear that major carriers have nowhere to taxi to escape the onslaught of the discounters. Even if United does persuade the board to give it guarantees in its third and final attempt, that won't solve what's ailing United.

United has already made deep cuts since entering bankruptcy in December, 2002, lowering costs by almost a third. Pilots, aircraft lessors, and retirees have all chipped in to create $5 billion a year in savings. Still, that's nowhere near enough to return the carrier to health. With fuel costs soaring, United, like most legacy carriers, is still losing money. And low-cost players, which have gone from 16% of domestic capacity in 1998 to about 29% today, are flourishing. No amount of government aid can—or should—fix that.

If workers reject cuts in pensions, big carriers may have to sell assets

That's why United is going to need more cost-cutting and perhaps a smaller network to save itself. Industry analysts believe the company must attract a private equity investor with or without loan guarantees. But such a player would likely demand new management and cuts in areas once deemed untouchable. The biggest target: employee pensions that, in their present form, will cost the company at least $4 billion over the next five years. And if United cuts pensions, that would put pressure on American, Delta, and Northwest to do the same.

United and other so-called legacy airlines must continue to remake themselves—or die trying. Delta and Northwest are currently in negotiations with pilots to cut wages. Northwest is seeking givebacks from other unions, too. And Continental has warned it will need labor concessions to survive. Since 2001, the legacy carriers have chopped operating costs by $13.4 billion and have reduced payrolls by 100,000. Yet so far not one network major "has gotten to where they need to be for long-ter viability," says airline expert Daniel M. Kasper of consultan LECG Corp. Pensions aren't the only problem. Health benef inefficient work rules, and seniority-based pay scales rem crippling. And with sky-high fuel prices and leaner winter tr el ahead, maneuvering room for some big players may run o

How the shakeout will unfold remains far from clear. Ev some of the carriers that seem most endangered, like US A ways Group Inc., could pull off a last-ditch transformation. A if the government rejects United's loan guarantee for a thi time, the carrier could gain the leverage needed to win far lo er benefits and wages, turning it into one of the most formid ble network players.

It's more likely that one or more carriers will follow in t footsteps of such dinosaurs as P Am, Eastern, and TWA. "Labor w clearly do something" at bo United and US Airways, predic one high-ranking airline executiv "Whether it will be enough is t question." Vaughn Cordle, a Unit pilot and financial analyst wl runs AirlineForecasts LLC, que tions whether airline employe truly understand the magnitude the problems facing their carrie especially the crushing debt a pension costs. If workers refuse make the necessary changes, he b lieves, airlines such as United w be forced to start selling assets. short, they'll slowly begin to liqu date, and that will only exacerba cost and revenue problems.

Of course, a move to shrink l some of the biggest players cou certainly help the rest of their b leaguered brethren. But those car ers will hardly have room breathe. Such low-cost juggernau as Southwest, JetBlue, and AirTra which could grab as much as 35 of domestic capacity by 2009, will continue to put pressure c costs and pricing. And those majors that do survive face a d ficult future with debt-laden balance sheets. "I don't see any them coming out strong," says credit analyst Philip Baggaley Standard & Poor's. More pain and turmoil clearly are on t horizon. And, as United is discovering, time is running out.

–With Michael Arn

EDITED BY MONICA ROMAN

HEADLINER

CHUCK FRUIT

HE'S NO SODA JERK

One of the most coveted jobs on Madison Avenue, the post of chief marketing officer at Coca-Cola, has been up for grabs three times since 1998, due to bad hires and strategy changes. And on June 22, it changed hands a fourth time: Coke's new chief executive, Neville Isdell, named veteran Coke marketing veteran Charles "Chuck" Fruit to replace Dan Palumbo, who is leaving to pursue other opportunities.

Fruit joined the soda giant in 1991 after 15 years at Anheuser-Busch and immediately helped develop Coke's long-running "Always" ad campaign. In recent years, he worked alongside Coke President Steven Heyer to freshen up Coke's stale marketing. Fruit also had a big hand in steering Coke away from the ubiquitous 30-second TV spots to newer marketing like Web sites and creating programming for TiVo. Now, with Heyer leaving after being passed over for the CEO job, Isdell is betting that Fruit will prevent an exodus of the talented marketing staffers Heyer brought in.

–Dean Foust

DRAWING A BEAD ON BONDS

The **Securities & Exchange Commission** has asked several brokers of so-called auction-rate bonds to examine their operations and provide written reports of any potentially deceptive practices. As *BusinessWeek* reported ("The SEC's Top Cop," BW, June 21), the agency, under Enforcement Chief Stephen Cutler, is probing whether some Wall Street firms' bond operations took bids from preferred customers after auction deadlines. Industry officials believe the SEC also suspects some brokers of colluding to set prices. Typically, investors buy long-term bonds and submit bids through brokers to set the coupon rate. The lowest bid becomes the rate at which the offering is sold. **The Bond Market Assn.** didn't comment.

LAST CHANCE FOR LAY?

Will the man who symbolizes the corporate-scandal wave, Kenneth Lay, soon be facing charges? The **Justice Dept.** isn't commenting. But the former **Enron** chairman's attorney, Houston-based Michael Ramsey, is worried enough about the prospect that on June 21 he made a public request for a last-ditch meeting with federal prosecutors to stave off an indictment. The government's case would probably mirror the one brought against former CEO Jeffrey Skilling and ex-chief accounting officer Richard Causey—and is likely to focus on the months when Lay reassumed leadership of the company in the summer and fall of 2001.

SBC'S FIBER BINGE

SBC Communications fired the latest salvo in the telecom wars with cable operators. On June 22, the Baby Bell said it plans to invest $4 billion to $6 billion beginning this summer to string fiber closer to millions of customers over the next five years. By laying fiber deeper into neighborhoods, SBC can introduce digital-TV service using a platform by **Microsoft**, plus speedy Net and phone service over DSL connections. The move is designed to counter cable rivals who have been invading the Bells' turf with offers of TV packaged with broadband and new voice service over the Net. The investment is contingent on a regulatory rule change that will clarify what pieces of the network SBC can sell and at what prices.

CHEMICAL TROUBLE

The chemical industry is feeling the heat. Probes by the **Justice Dept.** and authorities from countries such as Canada into possible price-fixing in the chemical business have accelerated recently. The two-year-old inquiries, which originally focused on certain chemicals used to manufacture rubber, have expanded to include other products, including urethane chemicals. The investigations have been aided by amnesty deals struck in recent years with Middlebury (Conn.)-based **Crompton.** While the company pleaded guilty in May to antitrust violations in rubber chemicals, it has struck amnesty deals with U.S. and international authorities concerning other businesses.

ET CETERA...

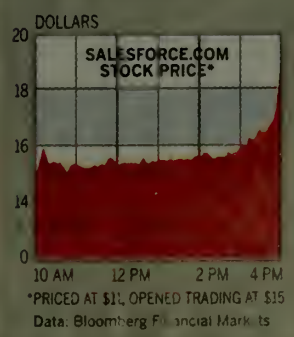
>>**AT&T** will exit the home phone market in seven states.

>>The **FTC** approved **R.J. Reynolds'** bid to acquire the U.S. assets of **British American Tobacco.**

>>**eBay** has acquired India's largest online auction site, **Baazee.com.**

CLOSING BELL

For a day, at least, Salesforce.com didn't have to do much selling. After its IPO was priced at $11, shares opened at $15 on June 23 and closed at $17.20—a gain of 56%. Investors are upbeat about Salesforce's Web-hosted customer-relations software.



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BY RICHARD S. DUNHAM

Run, John, Run—Just Not Here

ONY KNOWLES IS A DEMOCRAT who knows how to win in Republi-an Alaska, a state that gave Al Gore political frostbite and just 8% of its votes in 2000. The popular former two-term governor egularly feuds with party liberals and makes it clear that De-ocratic standard-bearer John Kerry ought to give Alaska a wide erth as he campaigns for President. Now inning for the Senate, Knowles is posi-oned as the un-Kerry and trumpets his ipport for drilling in the Arctic National ildlife Refuge and his opposition to ex-nding the assault weapons ban. Knowles lls Alaskans he's "an independent fighter illing to take on both parties."

The Alaska Freeze-Out is an example of Kerry-Free Zone—one of many on 2004's olitical map. In conservative states, a lib-al senator from Massachusetts could irt Democratic chances in close House or enate races. Not that it's unusual for can-dates to shun their party's leader: In the 84 Reagan landslide over Mondale and e Clinton-vs.-Dole debacle 1996, pols lower on the llot struggled to avoid go-g down with the sinking ip. What's new in 2004: e national race is a dead at, but candidates are ill dodging top-of-the-ket taint.

Chalk it up to Red-Blue tion. In the two-thirds of ates whose Presidential tes are already locked up, lose link to the likely loser n be the kiss of death. "If u're running ahead of a esidential candidate in ur state, you don't want to anything that will raise red flags," says litical scientist Andy Hernandez at St. ary's University in San Antonio.

Democrats have the most to fear this r: 22 of the 34 Senate seats up for grabs in states George W. Bush carried in 00, including five Southern seats vacated Democrats. North Carolina venture cap-list Erskine Bowles doesn't dwell on his e as Bill Clinton's Chief of Staff—or that lobbied Congress to ratify free-trade pacts—now that he's running for the Senate as a defender of the conservative state's besieged textile and tobacco industries. In neighboring South Carolina, Inez Tenenbaum is trying to keep the Dems' hold on retiring Senator Fritz Hollings' seat by playing up her opposition to gay marriage and support for the death penalty. "You can't benefit from being associated with Kerry in this state," says Clemson University political scientist Bruce Ransom.

HERSETH Kerry steered clear, and she won a South Dakota House bid

Political Pragmatists

REPUBLICANS ARE DOING their best to tie Democrats to their White House hopeful—and his fellow Massachusetts Senator, Ted Kennedy. In Alaska, the National Republican Senatorial Committee flooded the airwaves with ads suggesting that Knowles would cave in to Kerry on drilling. "Democratic candidates will meet Kerry at the border and tell him not to come," says the NRSC's Dan Allen, "while Republican candidates would welcome a campaign visit from President Bush with open arms."

Well, not everywhere. In Connecticut, where Republican Representative Rob Simmons' district cast only 40% of its votes for Bush, or in Buffalo, N.Y., where 53% of retiring Representative Jack Quinn's district went for Al Gore, local Republicans hope the Prez steers clear.

No Presidential candidate likes to face an unwelcome mat. But both Kerry and Bush are political pragmatists. That's why Kerry stayed far away this spring when Democrat Stephanie Herseth won a special House election in South Dakota. And it's why the polar ice cap will melt before Kerry is likely to venture into Alaska.

–With Alexandra Starr

CAPITAL WRAPUP

BUSH BIGS OPEN THEIR WALLETS FOR NADER

If you like George, can you like Ralph, too? Some **Bush**-hugging Republicans seem to have a soft spot for **Nader**. On June 23, two Democratic voters sued to block Nader's petition to get on Arizona's ballot, arguing that he has only 10,161 valid signatures. The Arizona Democratic Party says about half of those—4,727 names—while valid, are registered Republicans. Dems shockingly suggest that GOPers are backing Nader so he'll draw votes from John **Kerry**.

Dems call GOP aid to Nader a plot against Kerry

Nationally, at least three dozen Bush donors have opened their wallets for Nader. Among them: Richard J. Egan of Hopkinton, Mass., who maxed out with a $2,000 gift. Could this be the same Richard J. Egan who was chairman of EMC Corp.? Who served as President Bush's ambassador to Ireland? Who has raised at least $200,000 for Bush?

No, Egan's assistant says, that's "a different Dick Egan." What a coincidence, since state and Federal Election Commission records show Dick Egan the Naderite living at the same address as Dick Egan the Bush Ranger. The Ranger's son, John R. Egan, a $10,000 donor to the Republican National Committee, also has ponied up $2,000 for Nader.

Collectively, Bush donors account for about $41,000 of the $1 million Nader has raised. Nader says he sees no evidence that Republicans are conspiring to hurt Kerry by helping him.

–Lorraine Woellert

MONACO One problem: Ferrari usually wins

AUTO RACING

WILL THE BIG WHEELS WALK?

BMW, Ford, and others are drawing up plans to quit Formula One

MAY 30 WAS A BALMY Sunday in the picturesque Eifel region of Western Germany—perfect conditions to savor the smell of hot rubber and the ear-splitting whine of V-10 engines. Indeed, 106,000 people thronged to the Nürburgring to watch Ferrari driver Michael Schumacher humiliate his opponents in the European Grand Prix. So why was Walter Kafitz, the track managing director, unhappy? "We were not sold out," he says ruefully. The track can hold 150,000, so 44,000 tickets went begging.

How can that be? Formula One is the most-watched televised sporting event in Europe, and its popularity is growing in Asia and North America, making it one of the few ways multinational corporate sponsors can reach a rapt global audience. Kafitz blames the empty seats on a slow European economy and the dominance of the Ferrari team. But others in the sport blame something else: one Bernie Ecclestone, 73-year-old patriarch of Formula One. Ecclestone, a former used-car dealer, owns the commercial rights to the racing series. He and his wife Slavica are worth $4.2 billion, according to Britain's *Sunday Tim*

Mercedes, Gruppo Ferrari Masera Ford, and others who finance Formu One teams grumble that Ecclestone ho too much revenue and power. That r sentment is fueling a major effort to for Ecclestone off the track. GPWC (Gra Prix World Championship) Holdings shell organization in the Netherlan backed by carmakers and chaired by Ji gen Hubbert, Mercedes-Benz's chief, h begun writing a business plan for a n auto-racing series that would seek usurp Formula One beginning in 200 when current contractual agreeme run out. The rebels are even screeni sports-marketing agencies to help pu the events.

Ecclestone is largely responsible f building up Formula One since he beg acquiring control over TV and mercha dising rights in the early 1980s. By one e timate, Formula One generates $1 billi from broadcast rights, merchandisin and track revenue. But o about a fifth of that goes the teams, who also g money from sponsors su as Britain's Vodafo Group PLC or Munich co glomerate Siemens.

The tycoon's refusal modify contracts, whi give him a guaranteed su and automatic annual i creases regardless of tick sales, has forced tra owners to raise tick

THE STAT

122 MILLION

Average number of viewers per Formula One race

Data: Grand Prix World Championship

rices and hurt attendance, critics say. ven more important, Formula One's TV udience has been eroding in core mar-ets, especially in Germany (viewership as picked up a little in other places). Now that Formula One isn't as popular, here should be countermeasures—more nvestment, more promotion," says an in-ider at one auto maker. "Ecclestone is ot doing those things." Ecclestone, for is part, blames the track owners. "They on't promote anything," he says.

The carmakers have threatened to ave Formula One before. Are they more serious this time? "In no other sports series are the participants made to live with so little as in F1," Luca di Montezemolo, president and CEO of Ferrari and chairman of Italian auto maker Fiat, says through a GPWC spokesman. Ecclestone ridicules the chances of a rival series. "The people they're talking to have no idea of Formula One," he says, speaking by phone from London. "It's like me starting up a rival car company."

Building a rival series would be a huge challenge. The car companies in GPWC, which also include BMW and Renault, would probably have to spend over $100 million a year for at least five years, estimates Jan Wendt, vice-president for motor sports at Hamburg sports-marketing consultant SPORTFIVE, which is no longer involved in Formula One. "It requires a huge up-front investment, and the risk is very high if there are two rival series," Wendt says. GPWC counters that startup costs would be more than offset by an increased share of the revenue.

Ecclestone will certainly try to torpedo the effort by exploiting competing interests. Toyota Motor Corp. and Honda Mo-

GERMANY

Porsche's Latest Entry Hits a Crowded Track

The sun broke through billowy clouds as a procession of new Porsche 911 Carreras rumbled out of the courtyard of a 434-year-old German castle in Hameln, piloted by test drivers eager to tackle curvy country roads and speed down the autobahn. In this Old World setting, Porsche Chief Executive Wendelin Wiedeking on June 18 unveiled the new 911 Carrera, the company's flagship model, four months ahead of expectations. The surprise maneuver, which is trademark Wiedeking, should quickly reverse the ebbing sales of Porsche's aging sports car even as its Cayenne sport-utility vehicle fuels record sales and profits. "It was absolutely the right thing to do," says James N. Hall, vice-president of market researcher AutoPacific Inc. in Detroit.

Much is riding on the renewal of Porsche's 911 Carrera ($69,300) and the more powerful Carrera S ($79,100). The venerable 911 with its 14 variants accounts for 42% of the company's sales and more than half of profits. High-end 911 models such as Targas and Turbos, which range from $80,000 all the way to $440,000 for the 911 GT3, yield rich average profit margins of 22%.

But sales of the 7-year-old 911 were down 14% in fiscal 2003 and are expected to decline 18% in the year ending July 31, according to a report by Morgan Stanley. Wiedeking needs a new hit generation of 911s to build a war chest for a fourth Porsche model, expected to be a sporty four-seater coupe which is scheduled to roll out in 2009.

The New 911

U.S. LAUNCH Aug. 28

FEATURES New six-gear manual transmission with higher torque, wider girth, higher-quality stitched-leather interior.

MODELS	TOP SPEED	PRICE
911 Carrera	177 mph	$69,300
911 Carrera S*	182 mph	$79,100

*Bigger engine

Data: Company reports, *BusinessWeek*

Industry experts already are praising the sixth-generation 911 as a worthy successor to a model that has become an industry icon. With its wider rear end, narrower waist, and bigger 19-inch wheels, the new 911 gains in presence without marring its classic silhouette—something Porsche fans don't want to see changed.

What Porsche customers most yearn for in a new model is more oomph and driving finesse, and they get it in spades. The basic 911 comes with a powerful 325-horsepower engine with higher torque, plus a new, six-speed transmission. The Carrera S boasts an entirely new 355-hp engine that accelerates from zero to 62 mph in 4.8 seconds, and tops out at 182 mph. The Carrera S also comes with an electronic suspension system that allows the driver to lower the chassis for a sportier feel. "With the 911, it's the driver that counts. We are not trying to make a design statement," says Peter Schwarzenbauer, president and CEO of Porsche Cars North America. Wiedeking also upgraded the new 911's leather trim, fabrics, and instrument panel. Aficionados complained that the previous model shared too much with Porsche's entry-level roadster, the $42,600 Boxster.

The new 911 and its various offspring will vie for customers with the SL series from Mercedes-Benz, Aston Martin's new 450-hp DB9, and BMW's new, 333-hp 6-Series Coupé. "The giants have discovered the sports car sector as a lucrative niche," says Wolfgang Dürheimer, Porsche's director of research and development. But the fiercest battle for Porsche is in the entry-level sports car sector, where the Boxster goes head-to-head with BMW's Z4 roadster, Nissan Motor Co.'s 350Z, and others. The Boxster's sales are forecast to slump 32% this year as newer models steal the limelight. Insiders say Porsche will unveil the new Boxster six months early at the Paris auto salon in September.

Together the two new sports car models should help boost sales 9% in fiscal 2005, to an estimated 80,000 vehicles, with revenue rising 16%, to $8.5 billion. That kind of growth will help Wiedeking stoke up cash reserves for the fourth Porsche model. Wiedeking is no doubt plotting its launch just as his new 911 Carrera is ready for the next pitstop.

–By Gail Edmondson in Hameln

tor Co. are staying neutral for now. Any new series would be weaker without their support. Then there are the three banks that own a 75% stake in Slavica Ecclestone Corp. (SLEC), the holding company for Formula One.•Lehman Brothers, J.P. Morgan, and Munich-based Bayerische Landesbank ended up with the stake after the bankruptcy of Munich media company Kirch Group. The last thing they want is to destroy the Formula One brand.

Last year it looked as though the carmakers, SLEC, and Ecclestone had reached an accord. In December, 2003, they signed a memorandum of understanding giving the car companies 50% of Formula One pretax profit and the right to appoint a chief financial officer. All seemed fine until Ecclestone demanded that the carmakers agree not to pursue plans for a rival series for 10 years. Ecclestone insists he needed the assurance in order to go forward with a planned initial public offering. GPWC balked and, in April, repudiated the memorandum.

Ecclestone isn't going quietly. He boasted recently that he was at his desk at 8 a.m. after returning the previous evening from the U.S. Grand Prix in Indianapolis. The dispute can be averted, he says, if the auto makers give him the long-term commitment he seeks: "We're happy to sign today." But it doesn't look as if this race is going to end so quickly. ■

–By Jack Ewing in Frankfurt with John Rossant in Paris

ISRAEL

EL AL: CLEARED FOR A PROFIT TAKEOFF

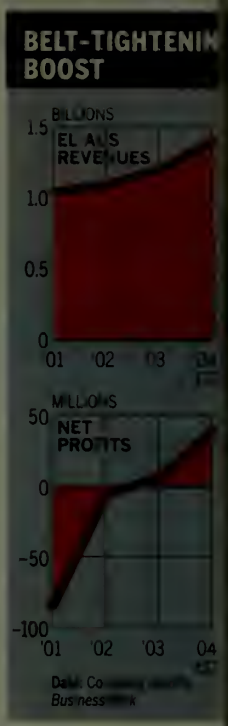
Deep cost cuts and a tourism rebound have lifted the airline into the black

GROUND CREW
E. A. trimmed 200 jobs

THESE DAYS, HOT AIRLINE stocks are a rare commodity. So with sky-high jet-fuel prices, a huge security bill, a dicey neighborhood to operate in, and years of losses, El Al Israel Airlines Ltd. would hardly seem like a smart play. But since last June, when the government finally got around to privatizing the carrier, the stock has rocketed up over 300%.

El Al is so hot that it has even generated some takeover buzz. Israel "Izzy" Borovich, the CEO of Knafaim-Arkia Holdings Ltd., a charter airline, is a local investor with a reputation for turning around companies. When most investors were steering clear of the El Al offering, the 63-year-old Izzy and his twin brother David snapped up its shares and options. Early this month, they exercised options worth nearly a quarter of the stock. By yearend the brothers plan to increase their stake to 52%, pending regulatory approval to exercise their remaining options. In that case, for a mere $68 million, they will have gained control of a company wit market cap of nearly $300 million. Indu try insiders say they are studying optio such as a merger between El Al and Ark or an alliance with a foreign carrier. "Co solidation is taking place in the indus worldwide, and there is no reason shouldn't happen here," says Izzy.

At the time of the IPO, El Al was de ing with the aftermath of the Septem 11 attacks and the war in Iraq, as well the intifada and a fiscal crisis in the government. "While U.S. airlines were getting $9 billion in [post-September 11 aid], our government slashed its participation in El Al's security bill," says CEO Amos Shapira. To sell off El Al, the government offered just 15% of the stock at 14¢ each, selling the rest as options for 1¢ to 3¢.



Shapira, an ex-Kimberly-Clark executive, took the reins in March, 2002, and started cutting costs. He saved $500,0 in fuel costs in 2003 by cutting the nur ber of engines planes used to taxi on t runway. He also cut travel agent commi sions from 9% to 7%, trimmed 200 jo and reduced wages by 8%. Security, a v tal area, was spared the ax. Wage co have since dropped to 22.6% of revenu compared with 30% or more for Europ big carriers. El Al recently announced $4.5 million profit on record revenues $302 million for the first quart Tourism to Israel is up by 75% so far th year, and a record number of Israelis a going abroad. "We're looking at a $ million profit if jet-fuel prices remain their high levels," predicts Yuval Zaira, analyst at Israel Brokerage Investment Tel Aviv.

Foreign carriers have also bee adding capacity, and charter compa Israir introduced three weekly flights New York in June. But El Al is the so carrier with direct flights to East Asi and it dominates the local cargo bus ness. El Al, commercial success? Son things do change in the Mideast. ■

–By Neal Sandler in Jerusale

JAPAN

WHY DEBT COULD DRAG JAPAN BACK DOWN

As rates climb, Tokyo's huge obligations may bring on a full-scale fiscal crisis

IT'S A RULE THAT EVEN FLEDGling bond traders have memorized: Bond prices fall and long-term interest rates rise as a slow or no-growth economy begins to recover. That's precisely what's happening in Japan, which grew at an annualized rate of 6% in the first quarter after years of stagnation. And, as happens in recovering economies, Japan has seen a rise from 1.2% to 1.9% in benchmark 10-year government bond yields. It's a modest increase—yet it scares the daylights out of anyone familiar with the government's runaway debt dynamics.

Japan may be back, but so are worries about its accumulated government debt, which has climbed to 144% of gross domestic product, by far the highest in the developed world. Rising social security and medical costs in a rapidly aging society, declining tax revenues from fewer working citizens, widespread tax evasion, and, until recently, low tax receipts from the struggling corporate sector have all created a cavernous gap in the budget. To hold things together, the government has been issuing $300 billion annually in new paper since 1998 while relying on ultraloose rates to keep interest payments low. Still, some 21% of Japan's annual budget is devoured by refinancing older bonds and paying some $80 billion in interest.

Japan needed that debt binge to keep the economy from falling into outright depression during a decade of bank failures and anemic growth. But now that the country is growing again and rates are rising, serious minds in Japanese finance see a major-league fiscal crisis in store. Every 100-basis-point rise in debt yield adds about $40 billion in debt-servicing costs, according to the Ministry of Finance. Says Keio University professor Eisuke Sakakibara, the Ministry's top financial diplomat in the mid-1990s: "If interest rates [rise] to 3% to 4%, there would be a major problem."

DEEP SAVINGS POOL

SO FAR, PREDICTIONS of a crash in the Japanese bond market triggered by rising long-term rates haven't been borne out. One reason is that Japan has a deep domestic savings pool and a massive current-account surplus. What's more, the Bank of Japan, under Governor Toshihiko Fukui, has jumped into the act by buying bonds outright from the government as they are issued by the MOF. "The BOJ is monetizing 40% of MOF's JGB issuances," notes Merrill Lynch Japan Inc. economist Jesper Koll in Tokyo. That's up from an historical average of 15% in the postwar period.

As long as domestic demand holds up, optimists argue, the government should be able to keep spending more than it takes in. Unlike the U.S. bond market, where foreigners, led by Japan and China, own some 50% of tradable Treasury bonds, only 5% of Japanese paper is owned by overseas investors. So Japan doesn't have to worry about an exodus of foreign owners that would crush demand and send yields soaring. Indeed, back in 1995 and '96, when Japan had a growth spurt and long-term rates rose above 3%, the bond market didn't crash.

What could stir up trouble this time, paradoxically, is Japan's vastly improved economic outlook. Most forecasters see the economy growing 2% to 3% over the next couple of years, and deflation, a problem since 1998, ending next year. At some point, the BOJ, with all that liquidity sloshing around the system, will have to worry about inflation. Already there is talk of an "exit strategy" from Japan's near-zero interest-rate policy. But if that happens, the price the government has to pay to refinance its debt load will skyrocket.

Everybody agrees that Japan needs to get on a serious fiscal diet or raise taxes—and quickly. "At some point, the economy will not be able to provide enough resources for it to service its debt and avoid default," notes Thomas J. Byrne, senior credit officer for sovereign risk at credit-rating agency Moody's Investors Service. Some think the BOJ might be forced to simply tolerate high inflation, which would allow the government to pay off its bonds with cheaper yen—a radical solution.

Make no mistake: There are good things going on in Japan's economy right now. Yet the cold reality is that Japan is in a debt trap. It's a problem that will take years of steady growth and fiscal restraint to remedy. Until then, even a hiccup in Japan's bloated bond market could have grave implications for the government's finances. ■

–By Brian Bremner in Tokyo

Squeeze Play

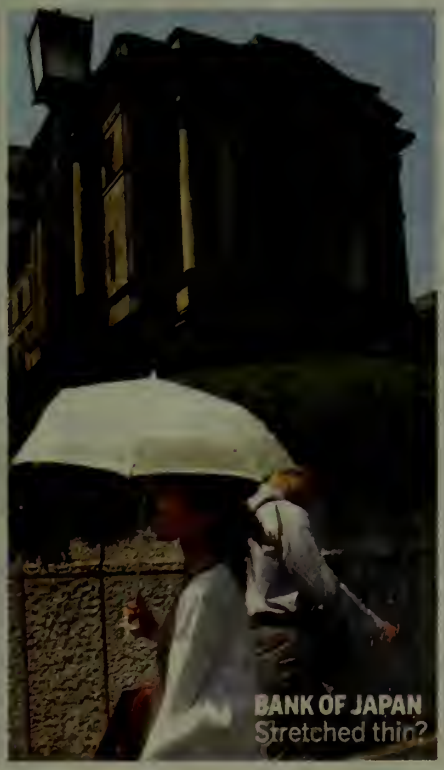
The effect of rising rates on Japan's debt

Accumulated debt as a percentage of GDP
144%

Gain in benchmark bond yields since Feb. 27, 2004
66 basis points

Debt servicing cost increase for a 100-basis-point rise in benchmark bond yields
$40 billion

Data: *BusinessWeek* Bloomberg Financial Markets



BANK OF JAPAN
Stretched thin?

COMMENTARY

BY PETE ENGARDIO

Dumping: China Strikes Back

But in its cases against Corning and others, Beijing isn't simply out for revenge

AT FIRST GLANCE, it looks like a typical case of tit for tat. On June 18, Washington set antidumping margins of up to 198% on a slew of Chinese manufacturers for allegedly selling bedroom furniture in the U.S. at less than the cost of production. That same day, China's Commerce Ministry announced a preliminary antidumping finding of its own—against Corning Inc.—assessing a 16% penalty on its sales of fiber-optic cables. A final ruling is due in 18 months.

CORNING-MADE
Optical fiber

China accusing Corning—the inventor and dominant seller of optical fiber—of unfair trade practices? That sounds rich. Judging from the torrent of cases filed against its producers globally each year, China is the world champion of dumping. In the U.S. alone, Chinese exporters have been found guilty in nearly all of the 58 complaints against them since 1987. What's more, critics say China undervalues its currency, lavishes cheap credit on manufacturers, has biased courts, and suffers from an abysmal record of protecting intellectual property. In Beijing in mid-June, U.S. Commerce Secretary Donald L. Evans said he is "concerned about the finding against Corning." Consultant Michael R. Wessel, a member of the U.S.-China Economic & Security Review Commission, a bipartisan congressional panel often critical of China, says such dumping suits are "a dangerous game for China, because they can inflame Congress." Corning says it will continue to contest the case.

So is Beijing unfairly targeting American companies to get back at the U.S. for the furniture ruling and a similar decision on color televisions in April? Actually, the jury is out. The complaint against Corning was filed last July, well before the furniture and TV rulings, and also involves a Japanese and two Korean suppliers. Indeed, most of the 27 antidumping cases filed by China since 1997 have been against Japanese and Korean exporters. Although there are plenty of complaints about inconsistency and poor transparency, U.S. lawyers say Chinese officials have been surprisingly professional in handling dumping cases. "They are still feeling their way around the fine points of the law, but generally they're following accepted practices and World Trade Organization rules," says Thomas R. Graham, a attorney representing Dow Chemical Co. in two pending case

At the least, Beijing appears to be no less fair than Washing ton, which free-trade advocates accuse of using dumping sui as protectionist weapons. China has thrown out several big ca es because its producers couldn't prove they were damaged. I September, 2002, for instance, Archer Daniels Midland Co. wo a dumping case involving lycine, an animal-feed additive. Als Beijing sometimes compromises on final duties, suspendin cases if exporters agree to hike their prices—something the U. rarely does. Dow hopes to strike such deals in cases on chlor form and the chemical ethanolamine, where it has been hit wit preliminary tariffs of 45% and 59%.

Perhaps more surprising: So far, no U.S. companies hav publicly complained of losing commer cial secrets as a result of Chinese invest gations. As in the U.S., companies th fight dumping cases in China must ope their books to government auditors t prove they aren't selling below cos Fearing such data will leak to Chinese r vals, some don't even contest cases ther But in the lysine suit, two Chinese aud tors spent a week in the U.S. poring ove ADM's records on its prices, what it pay suppliers, and its production cost "They are the most sensitive data w have, and there was tremendous anxiety, says attorney Warren E. Connell who represented ADM. "But th Chinese were quite competent. was impressed."

China says Corning may be selling fiber optics at 16% below cost

All this doesn't necessarily mea there's no ulterior motive behin the Corning action. Despite bein the technology leader, Corning ha sparred with Beijing for years ove access to China's huge telecor market. Also, Beijing has aggres sively promoted its own fiber-opti makers, who are reeling from th global telecom crash. And Washing ton fought Chinese efforts to sell optical fiber to Iraq an Afghanistan's old Taliban regime.

This makes the Corning case all the more important as barometer. If the final ruling is a sham, China-bashers will b justified in crying protectionism. But if it's based solely on th evidence, and the process is open, it could be a sign China is ma turing as a responsible trader with respect for the rule of law. ■

EDITED BY ROSE BRADY

Now It's Your Turn, North Korea

OR THE THIRD TIME IN 10 MONTHS, diplomats from six countries returned to the negotiating table in Beijing on June 23 to try and each an agreement on dismantling North Korea's nuclear programs—which Washington fears could soon be capable of producing a nuclear bomb a month. The Bush Administration ad pushed hard for the so-called six-party lks as a way to pressure Pyongyang.

But it turned out that much of the pressure was on Washington. With China, pan, Russia, and South Korea increasingly uneasy about what they saw as President eorge W. Bush's inflexibility, the Administration ran the risk of losing control of the lks. The result: a surprise U.S. proposal at lays out for the North the benefits of andoning its nukes. "The Administration is concerned that China, South Korea, nd Japan may be forming a little group ithout the U.S. and that this might make difficult for us to retain influence in the gion," says Ezra F. Vogel, a Harvard University Asia expert.

The proposal would provide North Korea with security assurances from the U.S. nd a resumption of heavy-el oil shipments from allies return for progress by Pyngyang toward a "complete, verifiable, and irreersible" dismantling of the uclear sites. The country ould have three months to nut its nuclear facilities, or id could be stopped.

The blueprint marks a harp reversal for Washington, which had demanded at Pyongyang agree to jetson its nukes before the U.S. specified hat benefits that would bring. North Korea had insisted on knowing Washington's uid pro quo in advance. Agreeing with Pyngyang, the other parties pressed Bush for road map for a pact and struck economic eals with the North on their own. Even apanese Prime Minister Junichiro Koizumi—up to now the staunchest backer of ush's tough policy—obliquely told the resident at the June Group of Eight summit that he should offer carrots to North Korean leader Kim Jong Il.

DEAR LEADER How will Kim respond to the U.S. move?

Barbaric Act

THE AMERICAN hard line in the talks, plus the war in Iraq, have eroded Uncle Sam's position in the Pacific. China is winning kudos for playing peacemaker in Korea and easing tensions with Japan and India. "[The Chinese] are eating our lunch," says Francis Fukuyama, a former State Dept. official and now professor at Johns Hopkins University School of Advanced International Studies. In South Korea, anti-U.S. sentiment is sure to rise after Iraqis beheaded a South Korean translator on June 22. The barbaric act punished the government of Roh Moo Hyun for reaffirming plans to send an extra 3,000 troops to Iraq. Roh may have other reasons for resenting Washington: Some analysts believe the U.S. abruptly decided to withdraw a third of its force from Korea to rebuke Roh for his softer stance toward Pyongyang.

Washington's reversal on North Korea could help heal these wounds and pay dividends at home as well. It may defuse criticism that once Pyongyang kicked out weapons inspectors, U.S. stone-walling enabled the North to expand its nuclear arsenal without constraints. The tactical shift puts the burden on Kim to end a program that has given him power and legitimacy. No one knows if he will. But Bush just cut the odds that he will be blamed if the talks end in failure. And he may have slowed the erosion of U.S. influence in Asia.

–By Stan Crock in Washington, with Moon Ihlwan in Seoul and Dexter Roberts in Beijing

GLOBAL WRAPUP

REVVING UP GERMANY'S IPO MARKET

GERMANY'S POSTBANK was successfully floated on the Frankfurt Stock Exchange on June 23, but only after owner **Deutsche Post** slashed the share price and the size of the offering. Deutsche Post CEO Klaus Zumwinkel had hoped to raise $3.6 billion by selling 49.9% of Postbank for as much as $43.80 per share. But investors balked at the terms, and he had to content himself with off-loading just 33% at $34.20 a share. Along with a related convertible $1.2 billion bond, the initial public offering—Germany's biggest in four years—raised just $3.1 billion. Investment bankers say the deal shows that the IPO market is finally reviving—at least for companies that price their shares realistically.

NEW MEDIA BARONS IN LONDON?

BRITAIN WILL gain two new powerful press barons if the Barclay twins, Frederick and David, prevail in their bid to buy the *Daily Telegraph*, the country's largest-selling broadsheet. **Hollinger International,** which owns the *Telegraph*, has accepted the brothers' $1.21 billion offer for the group. But Conrad Black, Hollinger's former chairman, who retains a 72% voting stake, may fight the sale, which includes the *Sunday Telegraph* and *The Spectator* magazine.

The Barclays, 69, have taken a hands-off approach to the editorial side of other media properties they have acquired, such as *The Scotsman* newspaper. Still, London is buzzing with speculation that they may distance the *Telegraph* from the Conservative Party. The paper is often labeled a Tory house organ.

THE GLOBAL RECOVERY IS GAINING TRACTION, AND AT CORPORATIONS around the world, high-octane design is fueling the strong rebound. Whether it is with breakthrough new products, hybrid combinations of older ones, or research into rethinking the entire consumer experience, companies are using design to generate sales and profits. The 2004 winners of the Industrial Design Excellence Awards (IDEA) demonstrate that design is playing a critical role for corporations as they turn away from cost-cutting survival tactics to return to strategies of growth.

The annual contest, sponsored by *BusinessWeek* and juried by the Industrial Designers Society of America, is usually full of surprises. This year is no exception. For the first time in the competition's 24-year his-

THE BEST PRODUCT WINNE

gold

CHEVROLET SUPER SPORT ROADSTER

Designers: General Motors Corp.; ASC Creative Services

It fuses classic late-'40s Chevy pickup style with two-seat-roadster design—for the first convertible truck. A retractable hardtop roof stacks vertically behind the seats. $41,995.

DESIGNS OF THE YEAR

RS 2004

tory, an Asian company won more awards than any U.S. or European corporation: Samsung took five IDEAs (including two golds), with Apple Computer Inc. the runner-up, won four (two of them golds).

Another surprise was that European design firms did exceptionally well in 2004. Sweden's Ergonomidesign, Germany's Atelier Markgraph, and Ireland's Design Partners each won two IDEAs. But the record was set by IDEO of Palo Alto, Calif., which took 10 awards, the most for a design firm, including six golds, while New York's Smart Design and San Francisco's fuseproject tied for second with five IDEAs each.

Surprising too was the the large number of hybrid products that won awards. The Chevy Super Sport Roadster is a pickup truck that is also a convertible roadster. It won a gold. Nokia Corp.'s 7600 reinvents the cell phone by integrating it with a Gameboy-like device. And Logitech takes two separate handheld accessories—a protective cover and a keyboard—and makes them one.

There were surprises in the redesign of existing products as well. The Apple iPod Mini, of course, is a wildly successful second iteration of the iPod. But look also at the beautiful new swim fins by Décathlon of France (page 64), the new Weight Forward Hammer by Farm Design, Bloomberg's new terminals and Hewlett-Packard's gold-winning vertical scanner, the Scanjet (page 66).

Design's role in shaping consumer experiences is represented by ZIBA's gold-winning research for Umpqua Bank of Oregon. "We asked people: Why go to a bank when they can go online or to ATMs?" says Sohrab Vossoughi, founder of ZIBA. "We found that people want peace of mind from financial services." Umpqua's branches now look and act more like community centers than banks.

There are more design surprises in the pages ahead. ■

–By Bruce Nussbaum in New York

BusinessWeek online For a list of all the winners and a slideshow of products not pictured here, visit www.businessweek.com/magazine/extra.htm

> gold

LOGITECH KEYCASE

Designers: Design Partners (Ireland), ElekSen (Britain), IDEO, Logitech

A QWERTY keyboard that works with Palm handhelds is made out of ElekTex, a new "smart fabric" from ElekSen. The keyboard folds around the Palm, providing a protective cover for it. Looks like a wallet. $99.

> silver

WEIGHT-FORWARD HAMMER

Designer: Farm Design

A continuous, curved shape—from the hand grip to the "weight-forward" point of impact on the hammerhead—shifts the center of gravity and delivers more impact with less applied force. And it looks fierce. $30.

Winners For 2004

Here are many of the winners of the Industrial Design Excellence Awards:

DESIGN FIRMS	AWARDS GOLD	SILVER	BRONZE	TOTAL
IDEO	[illegible]	[illegible]	[illegible]	[illegible]
fuseproject	2	1	2	5
[illegible]	[illegible]	[illegible]		[illegible]
Design Continuum		2	1	3
[illegible]		[illegible]	[illegible]	[illegible]
Atelier Markgraph	2			2
[illegible]	[illegible]	[illegible]		[illegible]
Ergonomidesign			2	2
[illegible]		[illegible]		[illegible]
AK Designs		1		1
[illegible]	[illegible]			[illegible]
Altitude			1	1

CORPORATIONS	AWARDS GOLD	SILVER	BRONZE
[illegible]	[illegible]		[illegible]
Apple Computer	2	1	1
[illegible]	[illegible]		
Philips			3
[illegible]	[illegible]	[illegible]	
General Motors	1		1
[illegible]	[illegible]		[illegible]
IBM		1	1
[illegible]	[illegible]		
Logitech		1	1
[illegible]			[illegible]
Panasonic		2	
[illegible]		[illegible]	[illegible]

∨ silver

BLOOMBERG TERMINAL

Designer: Antenna Design

It has a dual-screen display plus a keyboard with a fingerprint scanner for access to proprietary analytic software, customized keys and speakers, and a microphone for "squawking." For lease.

∧ gold

iPOD MINI

Designer: Apple Computer

A click wheel makes it even easier to use than the original iPod and saves space by integrating buttons. The mini, at 3.6 ounces, is half the weight of the original but still holds 1,000 songs. The size of a business card. $249.

∨ gold

UMPQUA BANK RESEARCH

Designer: ZIBA

In creating a new customer experience, ZIBA did behavioral and attitudinal consumer research. The result: Umpqua redesigned its banks to look more like community centers than austere financial institutions.

∨ gold

NOKIA 7600

Designer: Nokia UK

Welcome to the world of 3G broadband mobile communications. Nokia shifts the emphasis from voice to video and imaging by putting the screen at the center and the keys on the periphery of this cell phone. A new, iconic shape. $480.

d Over Five Years

IRMS	AWARDS 2000-2003	2004	TOTAL
	37	10	47
	13	5	18
	17	1	18
inuum	13	3	16
	13	3	16
	12	1	13
	7	5	12
Bell	11		11
	8		8
	6	1	7
	6		6
	6		6
	5		5

CORPORATIONS	AWARDS 2000-2003	2004	TOTAL
	15	4	19
Samsung	14	5	19
	11	2	13
Hewlett-Packard	7	2	9
	7	2	9
Microsoft	9		9
	7	2	9
Black & Decker (DeWalt)	5	3	8
	7	1	8
Herman Miller	7	1	8
	8		8
Philips	5	3	8

* frog design did not enter the 2004 contest
Data: Industrial Designers Society of America

sports
PERFORMANCE FOLLOWS FORM

THE CAULDRON OF SPORTS COMPETITION IS INCREASINGLY the place to look for great design. Here, design can make a huge difference in performance. The Kestrel Airfoil Pro bicycle, for example, has a revolutionary new shape that acts as a sail, pushing the rider faster and faster. The Tribord FLP 500 fins from France have oval holes in them, cutting water resistance and making swimming easier. Nike Inc.'s new Slingshot irons make it a lot easier for average golfers (who don't consistently break 100) to hit straighter and higher. And BMW's R1200 GS motorcycle not only looks hot but is also designed for more stability and better handling. In sports, functionality and flair do mix well.

^ gold

AIRFOIL PRO, FROM KESTREL BICYCLES

Designer: IDE

The rear end of the triathlon b functions as a sail in a crossw propelling the rider. The new design generated savings in manufacturing. $3,699.

> silver

TRIBORD FLP 500 FIN

Designer: Décathlon, France

An open window in the blade of the fin gives swimmers a more powerful kick with less effort. A comfortable foot pocket permits longer diving. Great colors. $31.

v gold

BMW R1200 GS MOTORCYCLE

Designer: BMW Desi Team, Germany

The front "beak," an oil cooler, makes this dual-purpose bike look tough. BMW shed weight and boosted the horsepower t make touring a breeze. Yet off-road riding is still fun. $15,100

^ bronze

SLINGSHOT IRONS

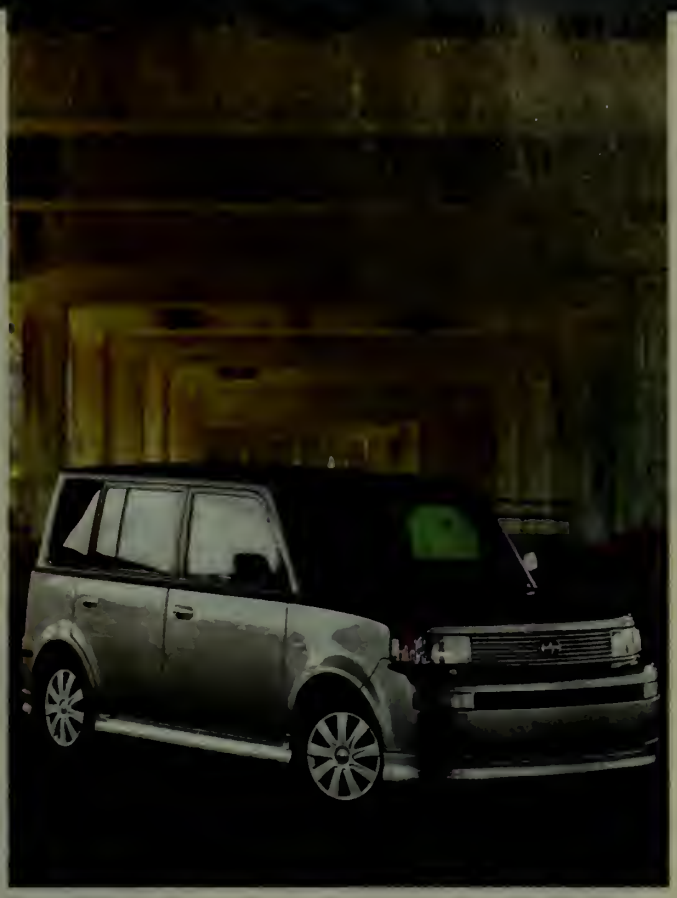
Designer: Astro Studios; Nike

Designed to make it easier for average golfers to launch the ball at a higher angle while shooting straighter. Think oversize tennis racket. $599 per set.

cars

TAKE A DRIVE ON THE WILD SIDE

HE DOMINANT DESIGN THEME AMONG THE CARS THAT WON DEA awards for 2004 is out-of-the-box thinking. This was year for innovation. The Chevy Super Sport Roadster ields classic pickup-truck and roadster designs to create n entirely new vehicle. The second-generation Toyota rius puts hybrid technology inside a sleek, appealing skin. he Toyota Scion xB throws out the conventional aerodyamic look for a boxy shape and lets consumers personale their cars with side-door graphics. And the Ford Cobra s a dream—a concept car stripped down to bare essentials or speed. Dream on.



gold

TOYOTA PRIUS

Designer: Calty Design Research; Toyota Motor; Techno Art Research

This second-generation hybrid vehicle creates synergy between ecology and fun. The four-door sedan doesn't look like a boring "green" car but an exciting automobile that also, by the way, has a gasoline-electric engine. $20,510.

bronze

SCION XB

Designer: Toyota

Targeting Gen Y, its square shape and sharp edges hunker down over the wheels. There are many options for customizing the car, such as body-side graphics. The second row of seats folds down—or comes out—to make room for bikes, surfboards, and other gear. Half the buyers so far are under 35. $14,165.

gold

FORD COBRA CONCEPT

Designer: Ford Motor

It's all about speed, and this rendition of the Cobra has nothing to slow it down: no side mirrors, no outside door handles, no windshield wipers, not even a convertible top. Pure power and muscle.

high tech

SEEING AND HEARING IS BELIEVING

HIGH TECH IS OFTEN AN ARENA FOR INNOVATION, AND THIS year is no exception. A noise-suppressing cell-phone earpiece that employs military technology, the Aliph Jawbone, is just one example. Hewlett-Packard Co.'s vertical Scanjet reinvents the flatbed scanner by turning it on its side and making the device mobile. It's a new paradigm for the product. The Taiwan-based BenQ made an LCD monitor that also breaks the mold. Its butterfly-wing design is a departure from conventional LCD screens. Panasonic's Toughbook laptop PC is different as well—it's designed to withstand the mud, rain, and dirt of heavy construction sites or combat zones around the world. Herewith, a host of new designs for new technologies.

> gold

HP SCANJET 4670

Designers: Smart Design; Hewlett-Packard

A vertical design takes up little desk space. The Scanjet sits in an easel holder. Open it, drop in a document, and scan. The removable frame can scan oversize books or even a picture hanging on a wall. $199.

^ silver

ALIPH JAWBONE

Designer: fuseproject

This cell-phone headset allows people to talk in a bar, restaurant, or any loud environment while suppressing most extraneous noise. A sensor rests on the jawbone so that when someone is not talking and just listening, surrounding sound is dampened. Rectangular shape looks cool. $129.

< silver

TOUGHBOOK CF-18

Designer: Matsushita, Japan

Tight-grips on the screen and body ensure a secure hold. Metal clasps make it easy to attach a shoulder strap. $3,300.

> bronze

BENQ LCD MONITOR

Designer: BenQ Corp.; Taiwan

An elegant butterfly-wing design departs from conventional liquid crystal displays. $495.

ifestyle

A WORLD STUFFED WITH FUN STUFF

THERE WERE ANY DOUBTS THAT DESIGN IS GOING GLOBAL, ıe 2004 awards quashes them. We have a Dutch company, hilips, designing a clock radio in China for the Chinese nd Asian markets. We have a Japanese corporation, Matsushita, designing microwaves for Americans who like their pizzas big—too big, in fact, to fit in most microwaves. We have a South African firm helping design an automatic pool cleaner for the U.S. market. And yes, we even have a small New York design firm, Built NY, creating an easy way to carry two bottles of wine to any party anywhere in the world. That's cool.

^ silver

MICROWAVE OVEN

Designer: Samsung

Big pizzas don't fit into microwaves. Samsung added a rounded door, and now they do. It also put the controls on the door itself at a 15-degree angle to make it easier to use. $99.

^ bronze

CLOCK RADIO

Designer: Philips Design, China

Targeted at young Asians, this baseball-shaped clock radio has bright orange colors and wake-up sounds that include frog, buzzer, sonar, and music/news. The front rotates to tune in radio stations. $20.

silver

ZODIAC G4

Designers: Zodiac Pool Care; Henk & I, South Africa

Specially designed rudders and sails and only one moving part make this automatic pool cleaner simple and longer-lasting than competitors. Bright colors make it stand out. $449.

> gold

NY BYO BAG

Designer: Built NY

Take bonded nylon/neoprene, to provide insulation and shock absorption, add fun colors, stitch the material so it carries two wine bottles in separate pouches so they don't clink but do stand up, and you get a great product. $16.50.

concepts

WHAT YOU DIDN'T KNOW YOU NEEDED

USING DESIGN RESEARCH TO REACH CONSUMERS IS one of the fastest-growing trends around the world. Smart companies in the U.S., Europe, and Asia are moving beyond designing merely for style. They are adapting design thinking and strategies to get much closer to their customers, who increasingly play significant roles in the development and creation of companies' new products and services. Cultural anthropologists, videographers, and psychologists are replacing conventional market researchers in the rush to really understand consumer behavior. And companies and designers are putting together teams to brainstorm about totally new ways of appealing to consumers. Not every corporation or design firm is yet on this wavelength. But those on this page certainly are. Samsung and Nike, IDEO and Design Continuum are leading the way.

^ silver

BIKEBUG RADIO CONCEPT

Designer: Design Continuum

When two cyclists want to talk each other, they have to ride si by side, which can be dangero The Bikebug is a voice-activate two-way radio. A radio attache to the back of a helmet, and a mike-earpiece fastens onto th helmet strap.

> gold

CIRCULAR PRINTER

Designer: Samsung

This concept has a portable printer for business travelers that moves in a circle rather than sliding back and forth on a flat plane. Says juror Christopher Alviar, principal at CG/A. "This idea sparks the imagination; a revolutionary design..."

v bronze

HIGH-PERFORMANCE GOLF TEES

Designer: Nike

Nike has 33 new tee ideas. The include tees made of fertilizer; tees that fit in a wallet; tees tha disintegrate on impact; and th Mojo, a tee with a liquid center containing Tiger Woods's swea (Remember, it's just a concept

< gold

HEIMSPIEL

Designer: IDEO

Brainstorm about people and products, and this is what you get: a scale that becomes just another tile in the floor after people use it.

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Reiner Schmitt, IT Manager
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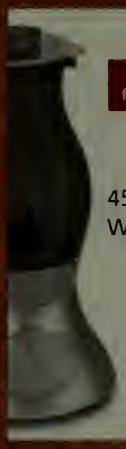

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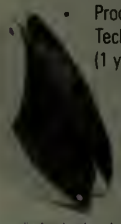

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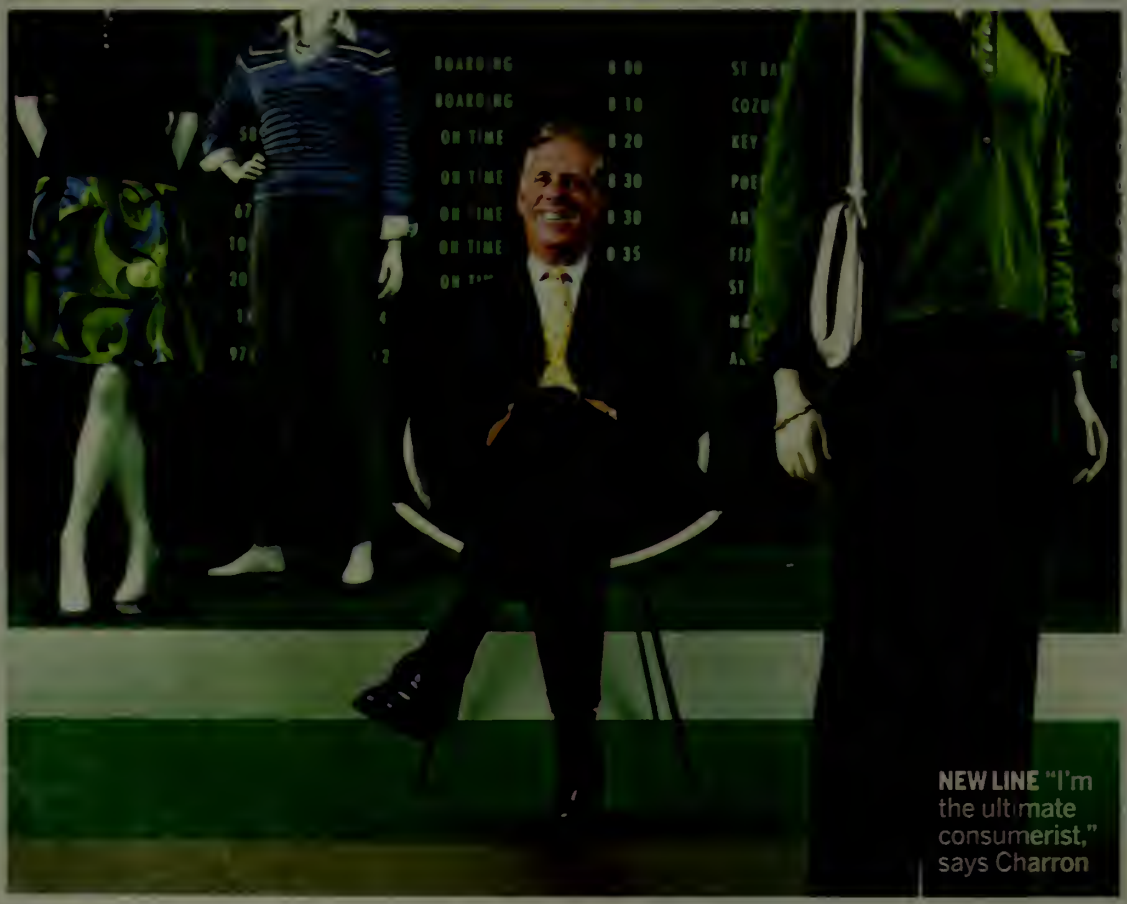
This site lists a brief description of the companies in the directory, along with contact numbers and company hotlinks.
It also features the IDEA Showcase of the 2004 IDEA winners, current industrial design news and resources, hotlinks to related sites and a calendar of design events.

BusinessWeek

No Nonsense At Liz Claiborne

CEO Paul Charron has turned the apparel giant into a model of pragmatism



NEW LINE "I'm the ultimate consumerist," says Charron

ALTHOUGH HE RUNS Liz Claiborne Inc., one of the largest apparel companies in the country, and although his office towers above New York's Seventh Avenue garment district, Paul R. Charron is no fashion plate. Favoring plain blue button-down shirts and silk ties, Charron, 61, is a wing-tip chief executive in a world of strappy high heels and $53 T-shirts.

It's his no-nonsense approach that has helped Charron turn Liz Claiborne into a model of pragmatism in the egocentric fashion business. Throughout the 1980s, the company succeeded by doing one thing well: catering to working women. The line offered a fashionable alternative to mannish suits, and women loved it. When founder Liz Claiborne retired in 1989, the company was the largest supplier to big department stores.

But by the time Charron joined in 1994, after years at Procter & Gamble Co., General Mills, and apparel maker VF, the company had become frayed around the edges. Rivals such as Tommy Hilfiger and Jones Apparel Group were coming up fast, and Claiborne had been slow to invest in the marketing and technology that w have improved its relationships with partment stores. Those stores were in t sition, too: Women were spending r money at specialty shops, and chains as Macy's and Proffitt's were devo more space to their own brands. A from its core line, the company had litt offer. Charron says the staff was alv wondering: "What would Liz be doin

BRANDED FASHION

CHARRON HAD his own ideas. He war to apply the Procter & Gamble philoso of brand management. "At P&G, I struck by the power of positioning dif ent brands just so," he says. "I've alw viewed this as a consumer-products dustry. My consumer proc happens to be fashion, ap el, and accessories."

For fashionistas, it wa revolutionary concept. there's no arguing with results: In the past five ye sales and earnings have b grown an average of 11% year, with net sales last y hitting $4.2 billion and income $280 million. Th largely due to a series of quisitions, mostly of still- trepreneurial upstarts. Th higher-margin busines have brought with them c cutting opportunities, wh Charron credits with company's increasing pr itability: Operating pr margins rose from 9. three years ago to 11.1% 2003. Says Arnold H. Ar son, managing director of tail strategies for K Salmon Associates Inc.: " Claiborne is really a mo for brand-building and po folio management."

Before Charron co bring in new brands, though, he had improve the company's inner workings. his first five years, Claiborne redesigned distribution process and overhauled computer systems. And Charron chang the measure of performance and the tr ger for bonuses to one common met That yardstick—direct operating profit— reinforced through quarterly perfor ance reviews and is now imprinted on t Claiborne culture: Two of the compan celebrity designers, Pamela Skaist-Le and Gela Nash-Taylor of Juicy Coutu call it "dope."

Phase Two—acquisitions—began

BIO

Paul Richard Charron

ong fascinated by why people buy what they do

JUICY COUTURE

BORN Aug. 24, 1942, in Schenectady, N.Y. His mother stayed home to raise six sons (he was the oldest); his father, an accountant at GE Appliances, died in a 1965 American Airlines crash.

EDUCATION BA, government, University of Notre Dame, 1964; MBA, Harvard University, 1971.

CURRENT POSITION Chairman and CEO, Liz Claiborne Inc.

BEGINNINGS Started as brand manager on Procter & Gamble's Joy liquid detergent. Worked at P&G from 1971 to 1978, where one of his jobs was launching Dawn. "I still go to the grocery store and think: That's me in a bottle."

LEADERSHIP TRAINING Served as a U.S. Navy lieutenant from 1964 to 1969. At 25 he led men into combat in Vietnam, receiving a medal for meritorious service.

FAMILY Married to Kathy, a speech pathologist and home decorator, for 30 years. Son Brad is a businessman. Daughter Ashley is a recent graduate of Cornell University.

99, when Charron purchased luxury de-ner Sigrid Olsen's business and Lucky and Dungarees. Last year, Charron sur-ised many when he bought Juicy Cou-e, a hip-in-Hollywood line of velour ck suits and logo T-shirts, for $53 mil-n plus future payouts. In all, a half-zen more purchases, combined with ands developed in-house, have reduced iance on the Liz line from 70% of its .4 billion in sales in 1997 to 34% of its .2 billion in sales last year. Claiborne w has 35 brands, each aimed at slightly fferent—still mostly female—shoppers. s expanding into retail, too: 20% of sales me from its own stores, including the exx chain, which offers trendy, moder-ely priced clothing.

Charron, who says he's "the timate consumerist," has long en fascinated by the question why people buy what they do. ill, as a young man he thought would be governor of Ken-cky—not a CEO. After a stint the Navy, he planned to go to w school and then enter poli-s. But a longtime friend and rrent Claiborne board mem-r, Paul E. Tierney, persuaded m to try Harvard Business hool, so he packed up his motorcycle d drove north to Boston.

In dealmaking, though, it's not his MBA at matters most. Charron believes per-nal chemistry is essential to smart buy-g. When he closes a deal, he almost al-ys wants the founders to stay on. He gives them considerable creative latitude while saving money on behind-the-scenes functions such as legal work and product sourcing. "When we met Mr. Charron, he said: 'Don't let us Liz Claibornize you,'" says Gene Montesano, co-founder of Lucky Brand Dungarees.

Initially, Claiborne wanted to handle shipping, but Montesano and partner Barry Perlman missed touching the clothes. An attempt to use Claiborne district supervisors for Lucky stores didn't work either. "We tried it. We didn't like it," says Montesano, who has taken on those roles again.

So far, Charron's deal-driven strategy seems to be working well, but there are dangers. Rivals are going after the same hot clothing lines, which has naturally upped their prices. And acquisition-fueled expansion is often hard to maintain.

In most buyouts, he likes to have the founders stay on

The biggest challenge may be finding someone to take over this more complicated operation. Charron won't retire for several years, but the board is already discussing who could fill his wing tips. That will be key if his management legacy is to prove as lasting as Liz Claiborne's fashion heritage. ■

–By Nanette Byrnes in New York

BusinessWeek online For a Q&A with Liz Claiborne CEO Paul Charron, go to businessweek.com/magazine/extra.htm

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Chicago Takes on Europe

A newly revitalized Chicago Board of Trade is fending off Eurex—for now

TO THE EUROPEANS AT the world's largest futures exchange, Eurex, Charles P. Carey may have looked like a hayseed. The jovial, burly chairman of the Chicago Board of Trade is much happier trading corn futures in the raucous pits than hosting meetings in the exchange's elegant boardroom. Eurex officials, who pan the open-outcry pits as a throwback to the precomputer age, won't say what they thought. But Carey figures "they viewed me as a corn trader who didn't know what I was doing."

If so, the Swiss and Germans who run Eurex are the ones who look like rubes now. Five months after Eurex launched an effort to steal the CBOT's mainstay business in trading U.S. Treasury contracts, the 156-year-old Chicago market is posting record volumes. In May it handled 45.8 million financial-futures and options contracts, up 26% in a year. Eurex U.S., ensconced in its spanking new offices in the Sears Tower, has barely laid a glove on the CBOT. It started with 255,007 Treasury contracts in February, but that fizzled to a paltry 51,556 by May. Says Carey, whose uncle and grandfather led the CBOT: "I was prepared to compete."

Compete he did. Carey, 50, a C member for half his life, took ov chairman in March, 2003, and issue immediate call to arms. Working wit CBOT's equally competitive CEO, Be W. Dan, he linked up with Eurex' P based rival, Euronext.liffe, for soupe computerized trading. Then he burie hatchet with the CBOT's fierce crosst rival, the Chicago Mercantile Excha and reached a deal to cut margin req ments and other costs to customers trade on both exchanges by at least billion a year. Finally, Carey cut tra fees on U.S. Treasury futures. For ex ple, the $1.25-a-trade fee for nonmem was trimmed to just 30¢. The pack was a winner: With it, "there wasn't reason to switch" to Eurex, says Mar Rzepczynski, president of Boca R (Fla.) trading firm John W. Henry & C

Carey may have won the opening s mish, but the Europeans aren't crying cle yet. On June 22, Eurex annour

ighting Back

OT Chairman Charles Carey moved fast to thwart a llenge from Eurex, the s-German bourse, by:

SWITCHING to a technologically superior electronic-trading system

TYING UP with the Chicago Mercantile Exchange to clear trades, saving customers at least $1.7 billion a year

SLASHING FEES for trading Treasuries by 75% or more, boosting volume enormously

LOBBYING Washington regulators, which delayed Eurex' plans for offering a full menu of products and services

ns to eliminate all fees for trading U.S. asury contracts from July 12 until the l of the year. And it will share up to 0 million in rebates with frequent ders to lure their business over the next years. So far, the CBOT says it has no ns to match those deals. What's more, egulators agree, Eurex will turn its U.S. eration into a global trading system by end of the year. It wants to let Euro- ns and Americans trade a full menu of t and equity-index products seamless- in each other's markets, clearing the des either in Chicago or Europe and is greatly expanding the pool of poten- Eurex U.S. customers.

With its deep pockets, Eurex can af- d a prolonged fight. Chief Executive dolf W. Ferscha maintains that the OT's price cuts, affecting only the ducts Eurex offers, are predatory. Eu- has filed suit against both the CBOT d the Merc for allegedly working to- ther to shut it out—something Carey smisses as sour grapes. Meanwhile, Eurex insiders in Frankfurt hint that the exchange's parent, Deutsche Börse, may be willing to swallow losses of more than 8 million this year to secure its U.S. hold—and to give the venture at least ee years to begin paying off.

NAL ISSUE ays the trading stay

Whatever the final outcome of the bat- , Carey has proven himself to be a sur- isingly effective change agent at the OT. The steps he took to deflect the st attack from Eurex might appear nple and obvious in hindsight, but ey were far from easy at a hidebound stitution seemingly intent on writing own obituary.

Longtime members, who own the OT and make their living in the pits, erely shrugged as Eurex surpassed it in 99 as the world's busiest futures ex- ange. As Eurex squashed other ex- anges in short order—forcing the ce-pits-based London International Fi- ncial Futures & Options Exchange to l out to Euronext—the CBOT seemed ore consumed with internal politics an with defending its turf.

Between 1999 and last year, two chairmen and two CEOs came and went after feuding over the future role of the pits. The self-inflicted damage was painful. Last year, Eurex' overall volume topped 1 billion contracts, double the CBOT's 454 million. Even the longtime No. 2 in Chicago, the increasingly computer-savvy Merc, moved further ahead of the CBOT, handling 640 million contracts.

"ARROGANT ATTITUDE"

FOR EUREX, TAKING direct aim at the CBOT's near monopoly on trading U.S. Treasury contracts made a lot of sense. "Prior to Eurex coming over, the Board of Trade had a very arrogant attitude, and they were overcharging," says Ray Cahnman, who chairs Chicago's Transmarket Group Inc. trading firm. Eurex thought it could quickly take advantage of the perception that the CBOT offered poor service and "outrageous pricing," he says. Adds Futures Industry Assn. President John M. Damgard: "Nobody ever thought the Board of Trade would be able to compete. You don't know how to compete until you've competed."

Plenty of people were eager to see a rival for the CBOT's Treasury business. So Eurex had no trouble signing up such big players as Goldman Sachs, Lehman Brothers, and Citigroup as financial backers. Federal Reserve Chairman Alan Greenspan supported Eurex' application to the Commodity Futures Trading Commission to operate as a U.S. exchange. The FIA and the American Bankers Assn. urged the commission to approve the application.

Are these groups disappointed with Eurex so far? Not really. After all, their members can now trade Treasury futures at bargain prices. "It has been very, very good for customers and it has been very, very good for the firms," says the FIA's Damgard. "I will be forever indebted to Eurex for making the effort to come here."

It has been good for Carey and the board, too. Even though they cut trading charges, they've more than made up for that in volume. The board's 24% rise in revenue in the first quarter this year, to $101 million, boosted net income 9%, to $16 million. The profit, helped by a surge in trading in the agricultural pits, amounted to more than half of last year's entire net income of $31 million. The result: The price of CBOT seats has nearly quadrupled, from as low as $240,001 in May, 2002, to $910,000 in the most recent sale on June 21.

Carey has been treading carefully around an emotional issue for many of his members: the future of the pits. For now, he says, they'll stay, even though their importance is diminishing. More than 90% of the trading in Treasury futures is now handled electronically, up by more than 10 percentage points from last year. For complicated options on Treasury futures, some customers find computerized trading not up to the job, and in volatile times, some think information such as who is buying and selling—sometimes apparent in the pits—makes the pits more valuable. "As long as people want to send their orders to the pits, we're going to keep them open," says Carey.

THE STAT

Number of U.S. Treasury contracts traded monthly*

CBOT

41.4 MILLION

EUREX

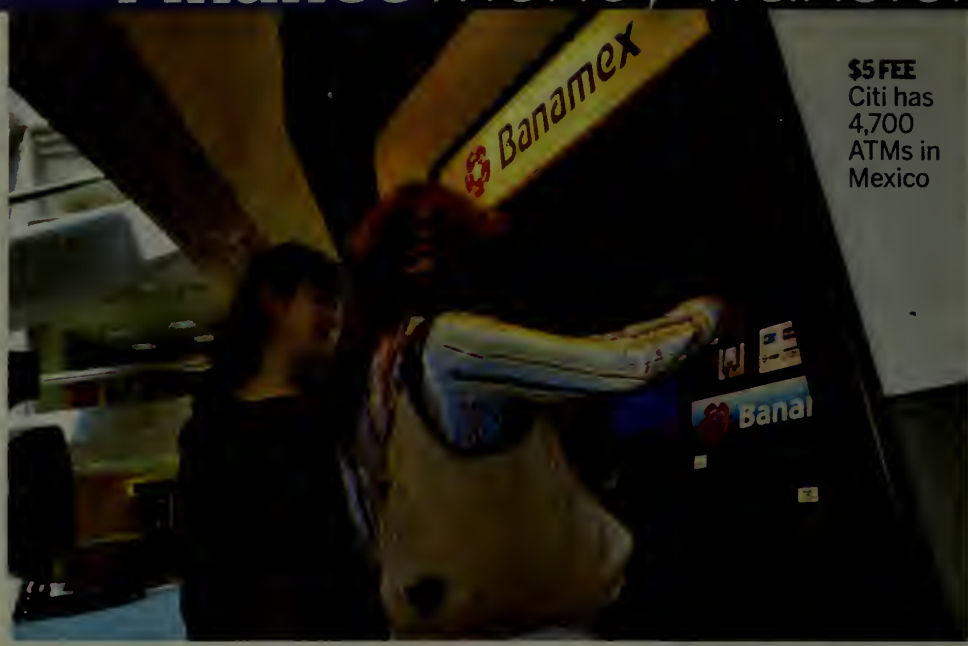
110,055

* Average of March, April, and May
Data: CBOT, Eurex

For Eurex, the setback means that the exchange must look for other corners of the market. It plans to give U.S. customers better access to trading futures and options in German government debt. And it aims to host trading in futures and options on European and American equity indexes, including the Russell 1000 and the EuroStoxx 50. But when it comes to Treasuries, the Chicago boys—"we're streetfighters, we're survivors" says Carey—are still very much on top. ■

–By Joseph Weber in Chicago, with David Fairlamb in Frankfurt

BusinessWeek online For a Q&A with CBOT Chairman Charles P. Carey, go to www.businessweek.com/magazine/extra.htm



$5 FEE Citi has 4,700 ATMs in Mexico

A Southbound River of Money

Will Citi's new cross-border credit card net a big slice of Mexican remittances?

THEY ARE THE GREAT unbanked—millions of Mexican immigrants who send billions of dollars to their native country each year. The battle for their business is hotter than a jalapeño on a July day in Texas. Banks such as Wells Fargo & Co. and Bank of America now accept ID cards issued by Mexican consulates. They're marketing debit cards that can be used by family members south of the border. And on June 15, financial-services juggernaut Citigroup launched what it bills as the first binational credit card. Says Rebeca Vargas, Citi's head of Hispanic markets: "This is a way for people who live in the U.S. to share their credit with people who live in Mexico."

The market is exploding. According to the Pew Hispanic Center, money transfers from the U.S. to Mexico doubled over the last three years to $13.3 billion in 2003, and they're now greater than the annual direct investment in Mexico by foreigners. The vast majority are made via small check-cashing and loan stores hooked up to wire services such as Western Union.

Wire transfers are expensive to send and a hassle to collect on the other end. "If you have to take a bus to get your remittance, it's a deterrent," says Anna Paulson, a senior economist at the Federal Reserve Bank in Chicago. But the escalating competition is rapidly bringing down the cost and easing the inconvenience. The fee to wire $400 to Mexico has fallen from $25 to $17 over the past four years, according to Pew. banks are pushing debit cards transfer costs of just $10.

Now, Citi's credit card will cut th even further. Citi charges $29 a ye the card, issued with its Mexican sidiary Grupo Financiero Baname largest bank in Mexico. After openi account with a Citi-affiliated ban U.S. cardholder, who is responsib the payments, chooses the peop Mexico who get a card—plus their s ing limit. The card is also good for withdrawals from ATMs in Mexico. drawals from one of Citi's 4,700 Me ATMs cost $5 a pop. Customers with credit history may have to put $1,0 so in a money-market account for, year until they have a payment histo

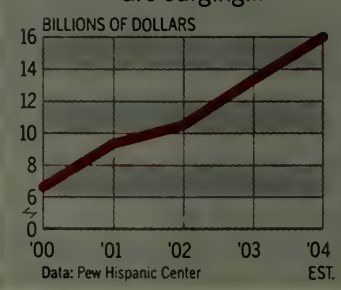
Will the Banamex USA card pr winner? Industry observers think s will earn interest on outstanding car ances, making card transactions profitable than the typical money tra And Citi, along with everyone else cr ing into this market, is using m transfers as a way of corralling custo for other banking products, suc checking accounts and home an loans. "This is like the milk in the ba the convenience store," says Daniel A director of cross-border payment Wells Fargo. Indeed, the potential is Only half of U.S. residents of Mexica scent have bank accounts, vs. 82% o tive-born Americans. In Mexico, just of the population has one.

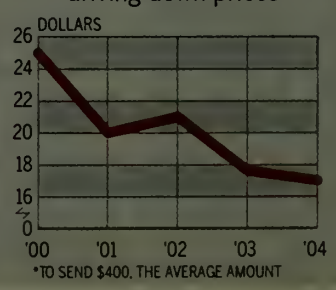
Citi's new card won't be for every Some rural Mexicans may have tro finding places that take the card. there is a long history on both sides o border of handling money transfers tirely in cash. Maria Vasquez, who m ages an apartment building in Los A les with her husband and sends $3 month to relatives in Mexico City, she'll stick to paying $10 at a time check-cashing store. "It's better to pay $10 and that's it," she says. "Then don't have to with banks."

Of course, suading folks s as Vasquez to up is exactly w Citi hopes to And that might mean fewer trips for the f back home. ■

–By Christop Palmeri in Los A les, with Geri Sr in Mexico

DINERO TO GO





EVEN OUR PRODUCTION FACILITY HAS AN EDGE

J.D. Power and Associates gave its highest honor, the Gold Plant Quality Award, to the Cadillac-exclusive Lansing Grand River assembly center This should come as no surprise, considering this two-year-old, state-of-the-art facility was specifically designed and equipped to produce world-class performing cars, like the CTS and the all-new 2005 STS, arriving this fall. What might come as a surprise, however, is that its excellence surpassed every automotive assembly facility in North and South America, including the leading import luxury manufacturers. Cadillac, edging ahead of the competition in yet another way.

BREAK THROUGH

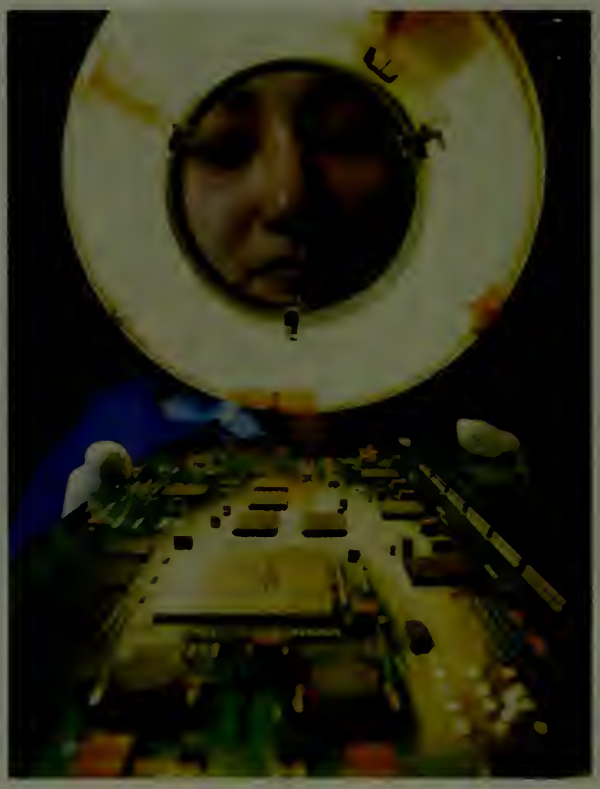
dillac.com General Motors Corp. — Lansing Grand River, Michigan (Car) plant was the highest ranked in North/South America among plants producing vehicles for the U.S. arket in J.D. Power and Associates 2004 Initial Quality Study.℠ Study based on a total of 51,208 U.S. consumer responses indicating owner-reported problems during the first 0 days of ownership. www.jdpower.com. ©GM Corp. All rights reserved. Break Through™ Cadillac® Cadillac badge® CTS® STS®

Networking Titans Buy the Future

After letting R&D slide during the slump, they're grabbing startups to fill the gap

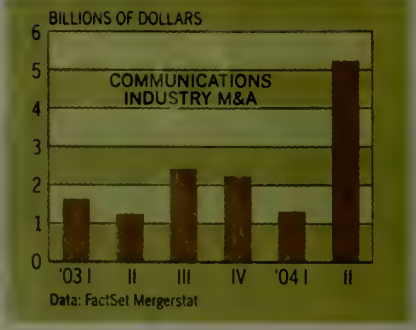
FOUR YEARS AFTER THE collapse of the telecom boom brought dealmaking to a halt, big equipment makers are again in a buying mood. At SuperComm, the annual schmooze-fest for big telecom providers and networking-equipment makers, which kicked off on June 21 in Chicago, there was a palpable buzz that the industry is finally getting past its funk. Dealmaking was very much in the air. "The bankers were swarming," says Pete Bonee, chief executive of startup Sylantro Systems Corp., which makes software to help telcos offer advanced corporate calling features over the Internet. Bonee met with three different bankers, all sniffing out deals.

Is this a return to the crazy days of the late '90s, when companies paid billions for unproven startups? After all, the industry has racked up $6.5 billion worth of deals so far this year, nearly as much as the $7.4 billion total for the whole of last year. So far, the answer is no. For the most part, these are necessary, strategic deals, say analysts. The likes of Cisco Systems, Lucent Technologies, and Nortel Networks are eager to get their hands on the technology they need to roll out the next generation of telecom services. These range from Internet-based telephony to digital TV. "The big guys are realizing they have gaps in their product portfolios—and they're willing to take whatever action necessary to fill them," says Joe Sigrist, CEO of startup Hammerhead Systems Inc., which makes gear that moves the telcos' data services to the Net.



AIRESPACE A strong No. 2 to Cisco in wireless networks

DIAL M FOR MERGER



The big companies are caught in a lurch because many throttled back their research and development to get through the bust. From 2000 to 2004, Lucent's R&D budget plummeted 60%, while Ericsson's fell 55%, and Alcatel and Nortel each saw roughly a 45% slide, according to investment bank Bear Stearns. Startups, on the other hand, felt they had no choic to innovate. Still, with orders scarce, n of these small fry were close to going u

Now, with the Bells and other se providers pushing the big manufact to acquire the latest technology, the promising startups are suddenly at ing renewed interest. Some, inclu wireless-network maker Airespace and broadband-equipment supplier C Networks Inc., have established m partnerships with industry heavies s as Nortel and Alcatel. Others will be chased once they prove that their tech ogy works as advertised. The most pr ising may opt for independence and a at an initial public offering. Consider space, a strong No. 2 to Cisco in the ket for corporate wireless works. So far this quarter, it sold more than four time much gear as it did in al 2003, says Vice-President Marketing Alan S. Cohen.

MORE TO COME

THERE COULD ALSO be bi deals as second-tier pla look to bulk up and muscle new markets. That's Tellabs, a maker of equipm that connects traditi phone networks to the Inter forked over $1.9 billion on 28 for Advanced Fiber C munications, which m broadband gear. To escape still-depressed optical working market, Ciena C has peeled off $636 millio the past year to buy four s ups. And some bankers ex another billion-dollar d "It's a risky business," c cedes CEO Gary B. Smith. " the bigger risk was doing nothing."

While most companies haven't o paid, one exception is Lucent, w shelled out $300 million for tiny Inter telephony software maker Telica in M The price is roughly eight times Telica's pected '04 sales—or about twice the m ple of most deals. "It's not necessaril desperate move," says Steve Coplan, rector of merger-and-acquisition anal for market researcher 451 TechDealma "But it smacks of indecent urgency."

Still, there's a big difference betw today and the late '90s. The startups ing acquired now have real technolog offer—and buyers have real needs, just blue-sky visions. ■

–By Peter Burrows in San Ma Calif., with Roger O. Crockett in Chic

OMMENTARY

EMILY THORNTON

Back to Making Money the Hard Way

ne casino days may be over for investment banks as interest rates head back up

WALL STREET firms have worked hard over the last decade to convince investors that their earnings are not volatile. ney have bought or built every conceivble sort of financial-services business to versify their sources of revenue, ranging om selling stocks to writing aircraft leas-. And when investors got the jitters lier this year about the likely impact of rising interest rates investment banks' earnings, they had a ready answer: When ot-based businesses slow down, others pick up the slack.

Unfortunately, that's not entirely what is happening as Fed-l Reserve rate hikes loom. Goldman Sachs, Morgan Stanley, nman Brothers, and Bear Stearns Cos. all announced second-arter earnings that soared by double digits compared with same quarter of 2003. Morgan Stanley's earnings even dou-d. But compared with the first quarter of this year, the four ns' combined net earnings still slid by 5% on average and ir revenues dipped an average 2%. That was worse than 03, when their earnings rose 5% and revenues were 4% gher in the second quarter than the first.

After basking in a sweet spot for quite a while, the banks may headed for a rough patch. Goldman Sachs, Lehman, and ar Stearns racked up record earnings in e first quarter largely because their bond d mortgage businesses were booming at e same time that stock and merger busi-sses were showing new signs of life.

Now the firms face a tricky balancing t. As interest rates rise, their debt-based sinesses will likely slow. Yet revenues om equities trading and investment nking could remain soft because of the ditional summer slowdown in stock arket activity and dealmaking. "Our tlook for the business environment in e coming months remains optimistic," oldman Sachs Chairman and CEO Hen-M. Paulson Jr. said in a statement. "But e are mindful of the effect of continuing terest rate and geopolitical concerns on arket sentiment."

RATE WATCH Goldman CEO Henry Paulson

Some strains are already evident. Until now, many investment banks have taken advantage of declining interest rates, trading bonds for money manager clients and for their own accounts. "Investment banks have been behaving like casinos and making large proprietary bets," says Wall Street veteran Michael D. Madden, a partner at private-equity firm Questor.

But the momentum is slowing. Goldman, Sachs & Co.'s fixed income trading revenues were up 15% year over year in the second quarter. But a year ago such revenues soared 44% compared with the same 2002 quarter. Research analyst James F. Mitchell at Buckingham Research Group expects the four investment banks' combined fixed income trading revenues to rise by 12% this year, after jumping 46% in 2003.

The firms insist they will not suffer from a downdraft as severe as past periods when rates have gone up. They argue that debt markets are now broader: Banks no longer deal only in simple loans and bonds, but now sell everything from collateralized loan obligations to interest rate derivatives. "There are so many different things that people do," Goldman Chief Financial Officer David A. Viniar said in a June 22 conference call. "What's most important is levels of activity."

All the same, the stock market has hoisted warning flags about investment bank stocks. Morgan Stanley has fallen from a 52-week high of nearly $62 per share in March to its current $52. Goldman has sunk to $92 from just over $109 in the same period.

The stocks could turn out to be cheap at today's prices if the investment banks' predicament improves in the fall. That's when stock trading and investment banking usually pick up again. Companies already are issuing more stock and announcing more mergers than last year. And many analysts raised their yearend estimates for investment banks' profits after the firms' second-quarter announcements.

Still, investors should probably brace themselves. They may be in for a bumpy ride as investment banks navigate through choppier markets.

EASY COME, EASY GO?

With rates rising and stock trading flat, investment bank profits may weaken

	NET INCOME SECOND QTR (BILLIONS)	CHANGE FROM PREVIOUS QTR
Goldman Sachs	$1.2	-8%
Morgan Stanley	1.2	0
Lehman Bros.	0.6	-9
Bear Stearns	0.3	-3.7

Data: Company reports

McDonald's: Fries With That Salad?

It has regained its momentum with a leaner menu. Now comes the hard part

ON MAY 6, MIDWAY through his 36-day biking-and-hiking trek across the country, Bob Greene, Oprah Winfrey's personal trainer, stopped at a McDonald's in Dallas. There, the fitness promoter was met by a former Miss Universe and the president of McDonald's U.S. operations to launch the fast-food chain's first-ever Happy Meal for grownups: an entrée salad, a bottle of Dasani water, and a "stepometer."

The timing was no accident. The next day, the burger-bashing documentary *Super Size Me* was set to open, chronicling filmmaker Morgan Spurlock's growing waistline as he gorged on nothing but McDonald's food for 30 days. Greene's pitch for McDonald's Corp. didn't dampen the crowds for *Super Size Me*: The movie now ranks among the five highest-grossing documentaries in U.S. history. But the new boxed meals helped counter the film's assault, as McDonald's in May totted up its 13th consecutive month of higher same-store sales.

NEW IMAGE

AT ITS CORE, McDonald's is undeniably still a burgers-and-fries outfit. But as the world's biggest restaurant brand fights the growing anti-obesity backlash, it has found a weapon: the salad. Its mixed greens and toppings are bringing in moms and other young women—exactly the customers it consistently alienated throughout the '90s with lame attempts to expand beyond beef-on-a-bun. Today the $3.99 salads are doing more than boosting profits. They're letting the Oak Brook (Ill.) company recast its image as a place where folks really can get a healthful bite to eat. "There has been a glow of improvement all around," says Irwin Kruger, who owns seven McDonald's stores in midtown Manhattan.

By finally appealing to women, McDonald's logged a stellar year

Ronald's rebound, though, is about to enter a tougher phase. The easy sales comparisons are over: Analysts predict McDonald's sales growth in stores open at least 12 months will slow to 5% or less in the second half of this year, when stacked up against the double-digit gains of late 2003. And while McDonald's customer ratings are up overall, its outlets still trail rivals in the critical areas of line waits, order accuracy, and store cleanliness, according to 2003 research by Sandelman & Associates, a restaurant consultant in Villa Park, Calif.

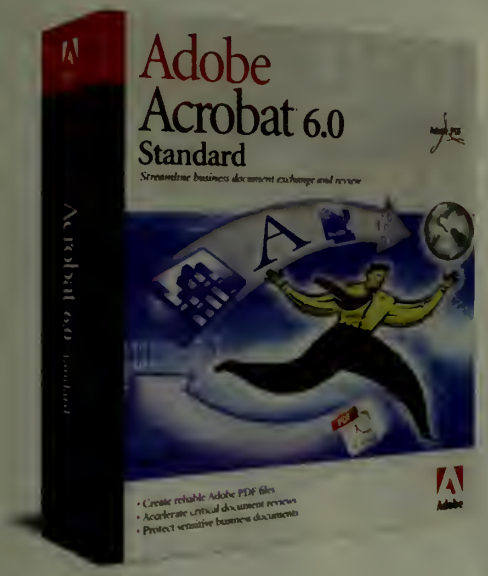
Meantime, McDonald's has to overcome its own internal health issues. Only 16 months after he was brought out of retirement, Chairman and CEO Jam Cantalupo died unexpectedly of a h attack in late April. Then, just two w later, the company disclosed its new and president, Charles H. Bell, 43, colorectal cancer. Bell, who was talupo's No. 2, has had surgery and i dergoing chemotherapy every o Monday. So far, analysts and franchi say, the turnaround that Cantalupo e neered in 2003 is still on track, and seems remarkably hale. They w though, that things might slip if Bell no longer run the place. All this expl why McDonald's share price, which bled during 2003, has been flat since February, at 27.

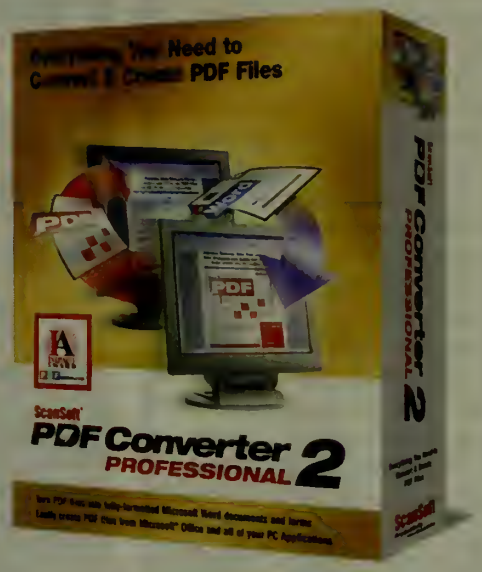
So a lot is riding on McDonald's a to convince customers it really has turned a ner. Bell has laid o relentless, restaurant restaurant operations grade. In 2004, he's p ning to remodel as m as 1,800 of McDona 13,600 U.S. stores start keeping 1,600 o around the clock. B moves have been prove boost per-store sales. Donald's is also polic franchisees, through ports by "mystery sh pers" as well as custon who can now call a toll- number with gripes. Donald's also plans speed service by allow customers to pay by cr card at more than 8, outlets by yearend.

At the same time, company is determine capitalize on the bo from its conversion t more healthful menu now offers all-white-m chicken in McNugg apple slices (albeit w sweet dipping sauce), a low-fat "milk jugs" Happy Meal options. T chain has dropped its S per Size fries and soft drinks. And it keep building its salad line. Tied in wit new Go Active! Happy Meal, McDonal came out with a fourth version of its trée greens, the Fiesta Salad, with s soned ground beef, Monterey J cheese, tortilla strips, and low-cal sal Several more salads are in testing, cluding one with fruit and nuts.

This isn't McDonald's first stab at off

Creation vs. Evolution





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ing salads—it first tried them in 1987. Then came a cholesterol-free muffin in the early 1990s and a low-fat burger, the McLean Deluxe. But McDonald's didn't really have its heart in it. Those offerings didn't taste very good, and the McShaker salad—which came in a big plastic cup—was poorly designed. Its lid often flew off and, despite vigorous shaking, the dressing sat on top. Patrons fled to fresher alternatives, from Subway sandwiches to Wendy's salads.

So what changed? For one thing, the market. By early 2003, when Cantalupo and Bell introduced McDonald's latest salad, obesity had been declared an epidemic. And this time, McDonald's took salads seriously. After months of experimenting and testing, McDonald's chose higher-quality ingredients, from a variety of lettuces and tasty cherry tomatoes to sharper cheeses and better cuts of chicken. It offered a choice of Newman's Own dressings, linking the entrée to actor Paul Newman, widely known for his nonprofit work. "The brand tie-in was a stroke of genius," says David S. Palmer, an analyst at UBS Securities.

NOT SO BAD Though they come with a sugary sauce

Of course, healthful is still a relative thing in fast food. McDonald's California Cobb Salad with grilled chicken packs 270 calories, about a third from fat. That's without dressing, which adds an additional 120 calories. That's a lot lighter than a 600-calorie Big Mac or 520-calorie large serving of fries. But the chain still sells eight times as many double cheeseburgers as salads. And its hottest new product is the calorie-packed McGriddle breakfast sandwich.

Salads may not be the core of the operations, but McDonald's still managed to sell 150 million of them in 2003. That's bringing in another kind of lettuce: Michael J. Roberts, president of McDonald's USA, says the average check for someone buying a premium salad is more than $8, nearly double the typical bill. Spurlock, director of *Super Size Me*, has proved to be a shrewd marketer. After all, he spent $65,000 to make a movie that, at last count, had taken in more than $7.5 million. With salads, McDonald's is showing that it knows a bit about marketing, too. ■

–By Michael Arndt in Chicago

Inventing To Order

Dow cuts R&D risk by finding out first what its customers need

FEW COMPANIES WOULD willingly gamble billions on a long shot. Yet when it comes to research and development, many do. Every year companies in the Standard & Poor's 500-stock index pour more than $100 billion into R&D. Sometimes it results in the kind of groundbreaking science that gave us lasers and AIDS drugs. More often it results in dead ends or intriguing innovations that nobody wants.

At Dow Chemical Co., scientists seeking a better batting average are using an approach that has been catching on in recent years, but with a twist. Before it heads for the lab, Dow solicits a wish list of products or technical characteristics from customers. If Dow can make w they want—and enough compa agree to buy it—Dow scientists will turn to the lab and invent to order. idea is similar to efforts at open-ma innovation attempted elsewhere, bu designed to build in guaranteed dem

The Dow method has its critics, say it leads to incremental improveme instead of revolutionary breakthrou Dorothy A. Leonard, professor emer at Harvard Business School, says tomers can't always articulate their sires and may have a tough time imag ing far-out inventions. Companies rely solely on such a customer-focu approach may find themselves out neuvered by competitors with m imagination. "The risk is that some c

Reverse R&D

Instead of developing new products and hoping customers love them, Dow sta with what the customer actually want and works backwards. Here's how D applied that formula to launch a new stretch fiber, XLA, in four years:

"SOFT STRETCH" Shirtmakers wanted a fabric with XLA's more natural feel

tor can leapfrog you and that you will have the growth you need from new rkets, new customers, and new prod- lines," says Leonard. Even admirers of v's method say it has risks. Among m: inventing new products, only to out end users aren't interested. Says s Hagey, a Bain & Co. partner in its sumer products practice: "You want ick your partners carefully."

RKET PULSE

W'S LATEST innovation, a stretch fiber ed XLA, shows the potential of the "re- e innovation" approach. By taking market's pulse first, Dow discovered t its rivals so far had not: that appar- nakers wanted a "soft stretch" fiber a natural feel. That insight allowed scientists to return to the lab and develop a fiber that met their needs. While it's too early to tell if XLA will succeed, the signs are encouraging: Three apparel makers have rolled out shirts with XLA in recent months, and Dow will begin mass production in the fall. Dow thinks XLA could generate $300 million in sales in 10 years.

It won't be any cakewalk. Already, XLA has a tough rival in Lycra T400, a stretch fiber launched by DuPont Co. a few months before XLA. Koch Industries, which purchased T400 in April, is ramping up capacity. Compared with XLA, T400 has more stretch, less shrinkage, and better wrinkle resistance. Still, Dow thinks XLA's superior texture can help it crack markets that have been off-limits to spandex, including men's dress shirts. Says Jean Aukerman, global brand manager for XLA: "We're trying to expand stretch into new segments."

Yarn and cloth makers tested and refined XLA

When Dow began looking into fibers in 1998, it turned to ISIS International Inc., a Monroe (Conn.) consultant that over the past decade has helped Dow plastics launch five products. To start, ISIS gathered execs from more than two dozen companies that use fibers, promising to give them first crack at any new product that emerged from the process. ISIS CEO Richard A. Siegel got them to describe the characteristics they wanted that were unavailable. Says Siegel: "We're asking the market, 'What do you need?' and telling the client 'Here's what you need to invent.'"

With that insight, Siegel pinpointed six opportunities that could yield $1 billion a year in new business. Of special interest: the apparel market's desire for a new fiber with soft stretch, cottony feel, and resistance to heat and chemicals. For Dow, this was a revelation. Until then, Kurt W. Swogger, Dow plastics' vice-president for R&D, and his team believed the big money was in a spandex-type fiber that could undercut rivals on price. That critical insight—that the market wanted an alternative to spandex, not a low-cost imitator—helped Dow avoid a huge error.

SPINNING AND WEAVING

IN MONTHS, DOW scientists had a prototype they thought met the market needs. Over the next three years, it was tested by 14 yarn, fabric, and apparel producers and was fine-tuned by Dow. By September, 2002, Dow was ready to launch XLA and began working with spinners and weavers to create fabrics using the fiber. Earlier this year shirts with XLA by Calvin Klein, Perry Ellis, and Tommy Hilfiger showed up in U.S. department stores, where shirtmakers say they're getting an enthusiastic reception. And Dow has invested $30 million in a plant in Tarragona, Spain, where it plans to start production in a few months.

Dow pioneered reverse innovation back in 1991 when the plastics unit was in a rut. It hadn't had a single new product in three years, so Swogger paired Dow's technology for creating "designer" polymers with an intense customer focus. Today, Dow plastics moves four times the volume and achieves nearly three times the sales it did in 1991. Dow continues to spend about $1 billion a year on R&D but as a percentage of sales, research costs have fallen from 7% a decade ago to 3% in 2003. Customers may not always know exactly what they want, but every once in a while even scientists can learn a thing or two by asking them. ■

–By Louis Lavelle in Freeport, Tex.

TEN

g consulting firm Dow gathered her leaders from dustries, from et makers to h-care panies, and ed them for hts into the fiber cteristics they ed.

IDENTIFY

Using those insights, ISIS, which in the past had helped the plastics industry launch new products, identified six distinct opportunities—industry needs that were unmet by existing products.

CHOOSE

One of the most lucrative opportunities was in stretch fibers, specifically a "soft stretch" clothing fiber that would hold up to the high heat and caustic chemicals used in processing, ironing, and dry-cleaning.

DEVELOP

Dow scientists set to work developing a prototype fiber, which it then turned over to 14 leading yarn, fabric, and apparel companies to test. Using feedback from them, Dow was able to fine-tune the prototype.

COMMERCIALIZE

Dow gave each of those 14 companies first crack at the new fiber, which was a potentially huge competitive advantage, and later worked with them in developing new products that would take advantage of XLA's specialized properties.

ROCKY KNETEN

STEADY HANDS Relying on a trained staff, not automation

High Tech–And Handcrafted

Despite a recent recall, Medtronic sets the quality standard for heart care

IT WAS THE MOMENT EXECS AT Medtronic Inc. had always dreaded. In early April, the medical-products maker had to recall thousands of defibrillators after learning that the devices, implanted in the chests of patients with heart disease, were taking too long to discharge a shock as their batteries aged and lost power. At least four people may have died and another may have been seriously hurt as a result.

Product defects are intolerable when hearts hang in the balance. As Medtronic Chairman and CEO Arthur D. Collins Jr. puts it: "A single quality issue can deep-six a business." Yet Medtronic didn't go down. In fact, the company is boosting its already-dominant 53% market share in cardiac devices. That's because the slipup was an aberration at an outfit that, over decades of manufacturing, has become the standard-setter for quality. Medtronic and its rivals "all make fantastic products," says Dr. Stuart M. Portnoy, a cardiac-device specialist at PharmaNet Inc., a Princeton (N.J). consultant. "But Medtronic probably has the best reputat

Medtronic's name is built practices that both dependabl

counterintuitive. Where manufact in some industries rush to autor Minneapolis-based Medtronic treas its trained production staff. The $ lion company's implantable device made from trusted materials—not new compounds. And it doesn't us latest generation of microchips in it critical pacemakers and defibrilla "These are not laptop computers," Dr. Stephen Oesterle, Medtronic's s vice-president for medicine and tec ogy. For quality and safety reasons will never be first to embrace the ne coolest technology in these things."

NO FACTORY SECONDS

AT MEDTRONIC'S parts plant in Bro Center, Minn., bunny-suited employ clean rooms sit for long hours at benches, peering into microscop they manually apply dots of silicone electrical lead or thread wires throug polyurethane tubes. There are als vanced machine tools and banks of puters, but for many fine tasks, the pany finds that humans perform bet

Keeping heart-failure patients aliv powerful incentive to do flawless Consider one of Medtronic's n products, the InSync III pacemaker. $12,000 device—a silicon-packed sli titanium roughly the size of an a stopwatch—must be able to nudge a ward heart back to a normal rhythm in 18 seconds at any moment, for up years, or the wearer may die of hea ure. "Nobody wants a factory seco this market," says Thomas J. Gunde an equity analyst at Piper Jaffray & "You've got to be near-perfect."

For pacemakers, incremental re ment has been the path to perfecti not radical innovation. It took five to develop the InSync III, which wa proved by the Food & Drug Admini tion in February, 2003. At 77 gra slightly less than the weight king-size candy bar—just a quarter-inch thi is far sleeker than e models. Yet 80% of hardware in the new n is "legacy" material, mates Brian Urke Medtronic vice-pres for quality. At least 5 the software, he says, from previous designs,

> "We will never be first to embrace the newest... technology"

Once they had a prototype, Medtronic gineers followed with a battery of tests y call "shake, rattle, and roll" to see w much stress components could take fore breaking. Afterward, engineers d production managers pinpointed at had failed, fixed it, and cranked the t up to the next level, watching for the xt failure. In one test, the pacemaker hstood a force 40 times that of the th's gravitational pull. A typical laptop ks out at 3 to 5 G's.

None of these tolerances can be ieved without crews of seasoned staff. here are eyes on parts all the way down the process," says Connie Tucker, a 23-year veteran at Brooklyn Center. "You want to make sure your product is done right for the end customer because their life depends on it."

Quality also dominates discourse at CEO Collins' executive-committee meetings on Monday mornings. Every business unit gets audited at least once a year on quality, and the company regularly dispatches monitors to evaluate suppliers, too, says Dr. Susan Alpert, vice-president for regulatory affairs, quality, and compliance. Engineers also perform "autopsies" on almost all implanted devices returned to the company to gauge how well they held up—and discover ways to make them better. "All of that feeds back in, so it's a constant improvement," says Alpert, a former director of the FDA's office of device evaluation. "It's part of the culture."

Increasingly, Medtronic is applying its trusted quality tactics in new businesses. In 2001, it pioneered a hybrid implantable device with wire leads to three chambers of the heart. It eases symptoms of heart failure by coordinating the pumping function of the ventricles, and also can treat a potentially lethal rhythm disturbance called fibrillation (table). The InSync line of pacemaker/defibrillators helped Medtronic grab over 50% of the U.S. market for implantable cardiac products, despite fierce competition from St. Jude Medical Inc. and Guidant Corp.

Implantable products aren't confined to cardiac care. Medtronic also sells InSync-like devices that deliver mild electrical pulses to the spine to treat intractable pain. Another family of products stimulates the brain to treat Parkinson's disease and other movement disorders. Epilepsy, obsessive compulsive disorder and depression are targets for future therapies. "We're just scratching the surface," says Collins.

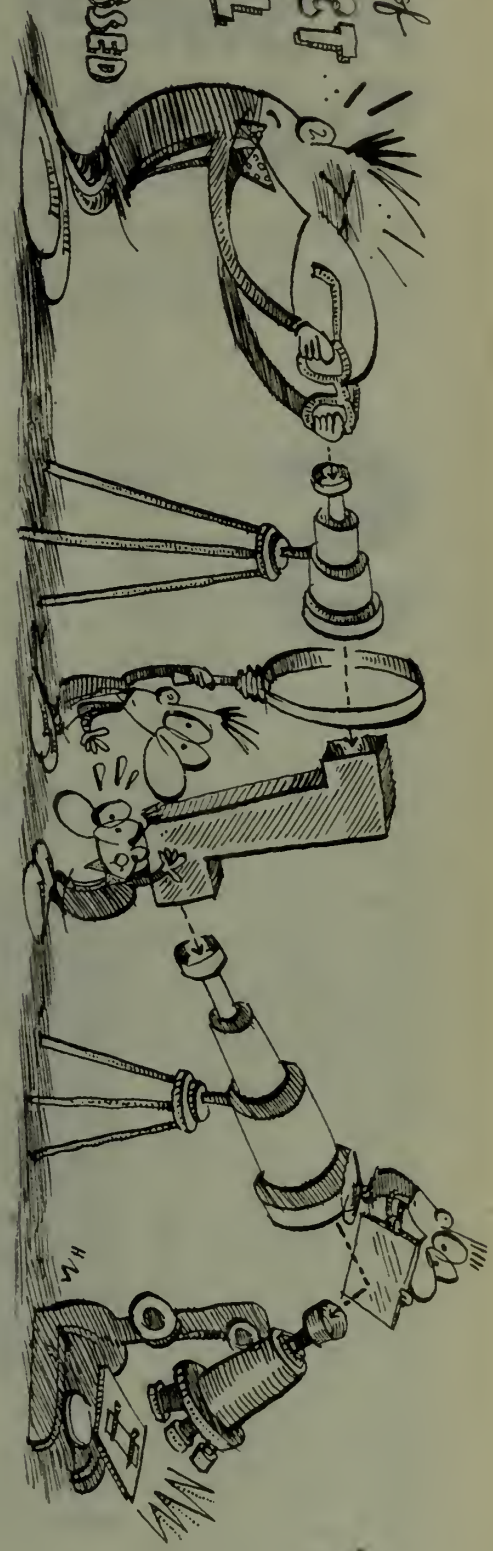
No one can predict the manufacturing challenges that will arise as these devices evolve. Still, Collins says, Medtronic's strategy will be consistent: Build devices made of materials you understand, from components that never fail, using workers who are committed to zero defects. These values are deeply conservative. And even on medicine's distant frontier, they may provide the best signposts. ■

–By Michael Arndt in Minneapolis

Built to Last

he latest Medtronic defibrillator 1) protects the heart from myriad ks. Implanted in the chest, it deliv- rs precise electrical impulses via wo thin, insulated wires (2) to the r tricle and atrial chamber on the ht side of the heart (3, 4), and via third wire to the left ventricle (5). r patients with heart failure—a ronic disease that afflicts some 5 illion Americans—it coordinates the mping action of the ventricles. And a patient develops a potentially thal rhythm disturbance, called fib- llation, it will respond in less than ht seconds with a life-saving ock. The device gets replaced once very six years.

BusinessWeek online For a Q&A with Medtronic's Chief Executive Officer Arthur Collins, visit www.businessweek.com/magazine/extra.htm



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A Sweet Deal in Suite Software

Startup SimDesk is starting to nibble at Microsoft's Office franchise

SIMDESK TECHNOLOGIES Inc. is a strange little operation, even for an Internet company. Its chief executive, Louis A. Waters, is not a techie but the retired head of onetime sanitation giant Browning-Ferris Industries Inc. And while it's little known, the 100-person Houston firm has a gargantuan ego. Having won a few deals over Microsoft Corp., executives are convinced the Redmond (Wash.) giant is obsessed with squishing them before they get too powerful. Among other fears, SimDesk founder Ray C. Davis believes Microsoft may have tapped his cell phone and worries that it has planted a spy in his staff. "I think they'll go to any limits to squelch us," says Davis.

But here's the strangest part: Microsoft should be a tad nervous. That's because SimDesk may be closing in on one of tech's Holy Grails: anytime, anywhere computing on the cheap.

For years, Microsoft, IBM, and others have painted visions of a future in which people could easily tap into their programs and information from whichever computer they happen to be using. But SimDesk is the first company to provide that promise in an ultra-affordable way. Individuals can log on to the SimDesk Web site, use basic programs, including word processing, e-mail, and spreadsheet packages, and store their stuff on the company's computers—all for just a few dollars per person per year. There's no need to spend $399 to buy Microsoft's Office suite of applications.

Microsoft dismisses SimDesk as little more than a gnat in its soup. "They're just another competitor," says Dan Leach, group product manager for Microsoft Office Systems. And the company denies that it has resorted to any dirty tricks to compete with SimDesk.

Yet SimDesk can't be shrugged off. Thanks mostly to a $5 million deal struck in 2001 with the city of Houston, around 200,000 residents have signed up for SimDesk's service. "I love it," says Kathy Hill, an administrative assistant in Houston's North Forest Independent School District. When she visited her father in the hospital recently, she says she was able to log on and continue working on the same document—"and my boss thought I was still at work!"

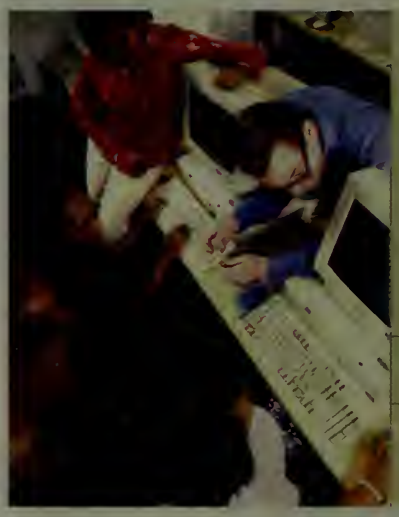
More users are on the way. By late 2005, as many as 400,000 Chicago public school students will have access. And on June 24, the state of Indiana was to announce it would make SimDesk a able to its 6 million residents. "A who has Internet access now also free access to a full suite of office ware," says Indiana Lieutenant G nor Kathy Davis. "I think this is th deal. It's one of the things Micros going to have to watch."

To be sure, Microsoft's William Gates III need not lose any sleep jus SimDesk is not yet profitable, and now is it cranking up its marketin forts. Any progress will take time. new SimIndiana program will at fi rolled out only to a few grade sch and job retraining centers. Inc SimDesk's technology—which is posedly capable of serving 20 millio dividual accounts from one ser hasn't yet been put through its pac a massive scale. Only about 5,000 tonians log on each day, says Davis

WAITING GAME

WHAT'S MORE, SimDesk isn't for e one. While its applications are com ble with Microsoft's ubiquitous and Excel, they lack some of the and whistles—including so-called tables used by spreadsheet mave crunch data. More important, who are used to instant response PC software may have to wait secon even the simplest commands trav SimDesk's servers in Houston and "Most people want the instantaneo sponse that comes from having grams on the desktop, not some far server," says Stephen Baker, analy market researcher NPD Group Inc.

Still, SimDesk is creating a buzz customers, particularly in state and governments. The company is in with public agencies in 31 states, as as Japan, China, and Germany, for riety of projects. Many see it as a w



TRAINING Who needs all the bells and whistles?

SimDesk's Pitch for the Pocketbook

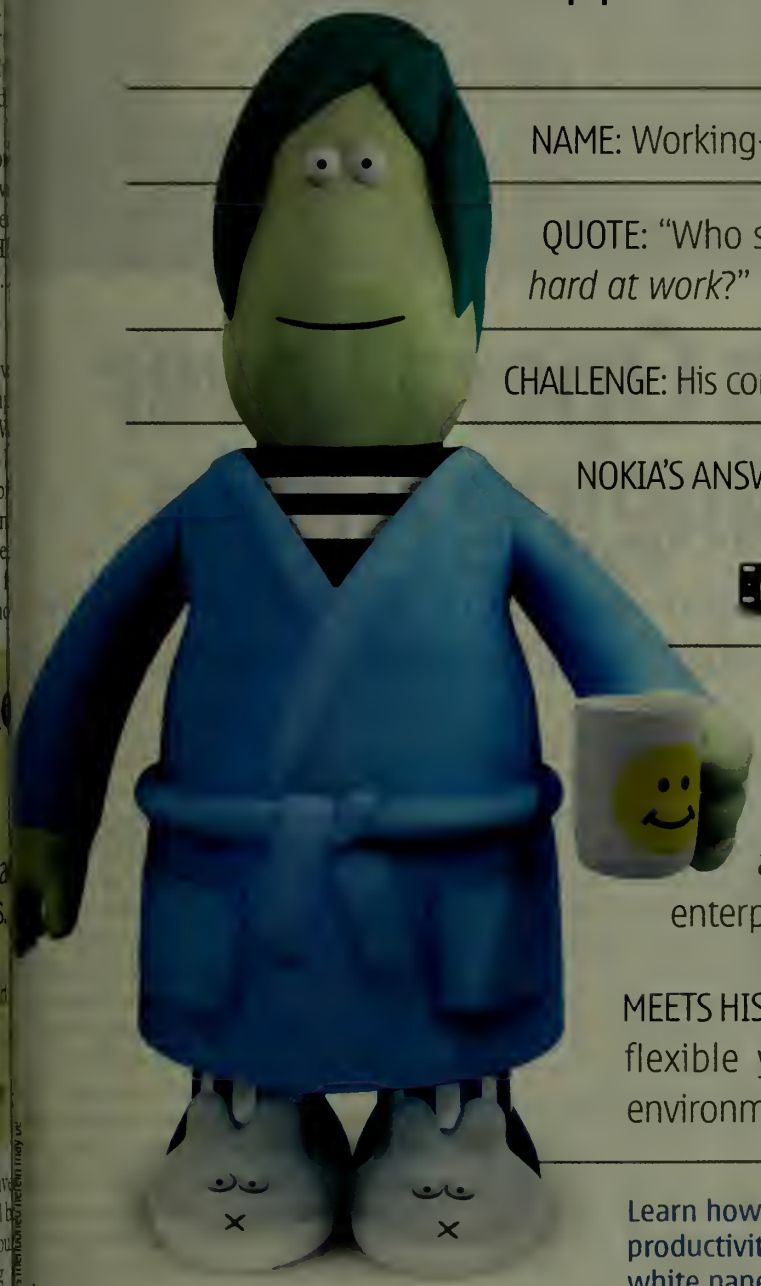
Tiny SimDesk is offering a cheap online alternative to Microsoft's Office suite. The city of Houston and the sta of Indiana are now offering this service to their citizens. The heart of SimDesk's appeal is economic.

- The service costs as little as $1 per resident per year—compared with $399 to buy Microsoft Office
- Because much of the software and all the data are kept on SimDesk's servers, customers can use older hardware rather than buy fast new machines every few years

Nokia for Business

Profiles in Business Mobility #6 | Productivity

Working-from-Home Walter now gets more done in slippers than in wingtips.



NAME: Working-from-Home Walter

QUOTE: "Who says I have to be *at work* to be *hard at work*?"

CHALLENGE: His company needs him. His family needs him.

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MEETS HIS COMPANY'S NEEDS by creating a more flexible yet cost-effective and secure work environment for valuable employees.

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cut their technology costs. By giving SimDesk to government workers who don't need Microsoft's full-blown Office, they can avoid those licensing fees and outsource some of their existing server operations to SimDesk. The city of Houston, for example, has begun shifting 13,000 employees to SimDesk, some via cheap disk-drive-less terminals rather than PCs. Such contracts attracted the attention of computer giant Hewlett-Packard Co., which may supply the hardware for the Indiana project, says one Indiana insider.

Other government agencies see SimDesk as a way to bring their PC-less masses into the Digital Age. Rather than pour money into PC buying programs, they can pay far less to sign up for SimDesk, and then provide access by setting up PCs at libraries, schools, and community centers. That way, even people who don't own a PC can communicate electronically for free, type up résumés, and do homework. Since all the programs and data are stored on SimDesk's own servers, it's no muss and no fuss for government tech managers.

So will SimDesk ever be important enough to truly make it Microsoft's Enemy Numero Uno? Doubtful. The company hasn't garnered the attention of tech industry analysts yet. One well-publicized snafu—say, lost files or privacy breaches—could quickly obliterate its credibility with governments. And it must still prove it can earn money when there aren't grants or taxpayer dollars to pay its bills.

Even success will be hazardous. If SimDesk's approach takes off, far more powerful players will likely get in on the game. Given their ability to satisfy the Web-surfing and e-mail needs of millions, there's nothing to stop Yahoo!, America Online, or Google from adding SimDesk-style capabilities to their offerings—and overwhelming the tiny company with brand marketing. Maybe more likely, SimDesk could be purchased. That was Davis' original plan when he founded the company. "My goal was to flip it to AOL or Yahoo, but then the Net bubble burst," he recalls.

He survived, but now that entails taking on mighty Microsoft. If millions of people start using the service and decide they like it, this quirky little outfit could emerge as a significant factor in the computing world. If not, you may hear one more little bubble pop. ■

–By Peter Burrows in San Mateo, Calif.

This Opera Lover Is Singing Again

The tech wreck rocked Alberto Vilar. Now his Amerindo is riding the Net's next wave

OF ALL THE INTERNET true believers, few suffered more publicly in the aftermath of the dot-com collapse than Alberto W. Vilar. Between the NASDAQ peak in early 2000 and its nadir in late 2002, capital managed by Vilar's Amerindo Investment Advisors Inc., one of the most aggressive investors in tech startups, dropped from $7.5 billion to less than $1 billion. Insult to injury: His name was stripped from the interior wall of the Metropolitan Opera House after he asked to delay payments on a $20 million pledge.

Well, Vilar is trying to make a comeback. The value of Amerindo's holdings in its private equity and mutual funds has climbed more than 200% from its trough, and now he's hoping that the anticipated initial public offering of Google Inc. fuels a runup in newly issued tech stocks—boosting Amerindo. The courtly 63-year-old Cuban American cl with anticipation. "One of these we'll get a very big bounce," he prec

He's not the only one who stanc gain. When Amerindo is flush, V takes sizable stakes in startups both fore and after they go public, then c holds the stock for years. That made the firm's marble-and-glass fices on New York's Park Avenue a r net for entrepreneurs on tech shows. Much of the world's opera c munity is rooting for Vilar as well. the No. 1 patron of that art—to the of nearly $100 million in pledges the past decade. If the markets coo ate, he plans to open his wallet ag But he warns: "Some people will nc on the list."

A CHANGE OF TUNE

VILAR ISN'T OUT for revenge, tho He's drawn to big risks and even bi rewards. He says he has learned f the bust. Vilar is willing to take pr

NEW YORK HOME
When Vilar is flush, opera stands to gain

when he thinks a bull market is topping out. For instance, late last year, after the big tech runup, he and partner Gary A. Tanaka sold half of Amerindo's holdings and gradually reinvested in new stocks—including Red Hat Inc., the leading Linux software company. But one thing hasn't changed. They're still looking for bets with a potential 1,000% urn, like the ones they got from Cisco stems and eBay.

The urge to buy and sell runs in Vi-'s blood, as does a love of music. He s raised in a posh apartment in pre-sto Havana by his father, also named berto Vilar, a successful sugar execu-e, and his grandmother, who encour-ed him to enjoy classical music. A n, sensitive child, he spent his time ding, listening to music, and at urch—where he was an altar boy. His her hated religion and forbade him to y the violin. His father's disapproval d teasing by other children shaped Vi-'s personality. "He's very competitive, ough he's quiet," says longtime friend rio Gaztambide. "He was out to ove to people that he was just as good better than the rest."

Vilar learned early lessons while grap-ng with the aftershocks of the Cuban olution. When Fidel Castro national-d Cuba's industries, the Vilar family t its fortune. "A lot of people go from s to riches. We went from riches to s," he says. And the loss was traumat-His father never fully recovered. Vilar, a young money manager in New York, voted much of his energy and finances helping relatives leave Cuba. He says patience he learned, and the focus on g-term goals, shaped his investment losophy at Amerindo.

Now he's hoping that strategy will ng Amerindo all the way back. He fa-'s technology companies that will ben-from the growing popularity of adband and wireless networks—such M Satellite Radio Holdings Inc. and iper Networks Inc. Analysts warn his volatile Amerindo Technology Fund is only for investors with steel nerves. The mutual fund declined 64% in 2000 and 51% in 2001. "I tell people, 'Don't buy this fund,'" says analyst Laura Pavlenko Lutton of researcher Morningstar Inc. But for those willing to take a chance with Vilar, the rewards can be sweet. The fund returned 84% in 1998, 248% in 1999, and 85% last year, trouncing others in its category.

A PATRON, AN INNOVATOR

STILL, THE IMPACT of Vilar's tumble left the opera world shaken. The banker delayed payments to a half-dozen outfits in addition to the Met, which won't comment on the matter. But, already, some people regret how the organizations treated him. One member of the Met board, who asks to be anonymous, says, "I think they made a mistake" by taking his name down. "His intentions were always good."

In his heyday, Vilar wasn't just a sugar daddy for opera, he was an innovator. He paid the bills so opera companies could try something new. And he showed plenty of stomach for risk. During a 2001 staging of Mozart's *The Marriage of Figaro* at the staid Salzburg Festival, which he backed, some in the audience started booing and shouting, "You're killing Mozart," when singers appeared on stage in miniskirts and jeans. "Alberto was just laughing. He knew that's show biz," says Karen Brooks Hopkins, president of the Brooklyn Academy of Music, who was seated with him.

Vilar went through an extremely dark period after the Met meltdown. He's divorced, with no children, and seat A101 in the opera house had long been his second home. But after his public embarrassment, he didn't return for more than a year. During the same period, he developed a back problem that required six surgeries. At one point it seemed he would never walk again. "The glimmer was gone from his eye," says Tanaka.

Now it seems to be back. During a tour of his 11,000-square-foot apartment overlooking midtown Manhattan, Vilar proudly shows off rococo furniture, paintings, and decor. His goal, he says, is to spend the next half-decade riding the new Internet wave so he can make good on his pledges to arts groups. He also plans on making large grants to health-care research and institutions.

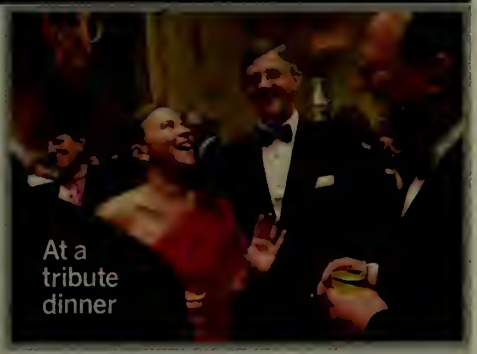
Yet as upbeat as Vilar has become, his emotional scars have not healed. Twice during a long interview in his apartment he returned to his treatment by the Met. "To bite the hand that feeds.... That's somewhere between dumb and abusive," he says bitterly. He finally broke his boycott by attending May productions of Wagner's *Ring* operas. Still, he says, "It was tough for me to go back there." It will take more than plaintive arias from Brunhilde to thaw relations with the banker in seat A101. ■

–By Steve Hamm in New York

BIO

Alberto W. Vilar

His life has taken him "from riches to rags" and back again


At a tribute dinner

BORN Oct. 4, 1940. He was raised in Havana by his grandmother and his father, a Cuban sugar executive, after his parents broke up.

CHILDHOOD PASSIONS Classical music, reading, and Catholicism. His father disapproved of religion and refused to allow him to play the violin. They clashed.

EDUCATION BA at Washington & Jefferson College, 1962; MBA, Iona College, 1969.

THE CUBA FACTOR After Castro came to power, Vilar's father lost his fortune and left for Puerto Rico. The son contributed his early earnings to helping relatives get out of Cuba.

CAREER Started in Latin America for Citibank, later moving to Drexel Burnham Lambert and The Boston Co. Co-founded Amerindo Investment Advisors in 1985.

OPERA Starting in the mid-1990s, Vilar became one of the art's leading worldwide patrons. He has donated or pledged more than $100 million.

HARD TIMES After NASDAQ crashed, his stocks lost three-quarters of their value. The Metropolitan Opera took his name off its grand tier after he delayed payments on $20 million in gifts.

BETTER DAYS His portfolio rose nearly 90% last year and is up more than 20% so far this year.

Can MCI Hold the Line?

As losses mount, it's racing to roll out new products–and stave off predators

WHEN IT EMERGED from bankruptcy in April, MCI Inc. had the makings of a fearsome competitor. The long-distance carrier was virtually free from its crippling $41 billion debt. It no longer lugged around the scandal-splattered name of WorldCom. In Michael D. Capellas, the former Compaq Computer Corp. CEO, it had an energetic leader who could hawk MCI service to legions of business customers. Perhaps most important, MCI boasted rich assets. Its crown jewel: the biggest swath of the global Internet backbone.

Scant months into MCI's new life, the company's rivals are hardly quivering. The Asburn (Va.) company racked up a $388 million first-quarter loss and faces declining revenues in most lines of business. Worse, MCI stands to suffer from the Bush Administration's June decision not to aid the long-distance carriers in their efforts to break into the Bells' residential market. It's a setback the company could withstand if its Internet businesses were prospering as expected.

But they're not. MCI's sales of Internet access to businesses—the company's core customer base—fell a steep 27.8% in the first quarter, to $465 million, while archrival AT&T's Internet revenues rose 5.9% in the same period, to $471 million. Overall, MCI's business Internet sales, which account for about 13% of total revenues, are expected to decline 18% this year, to $1.8 billion, while overall revenue contracts by 14%, to $21 billion, according to analyst Patrick Comack of Guzman & Co. in Miami.

Capellas, who was unavailable for comment, must now race to save MCI as an independent company. MCI's stock has dropped to just under $14, from a post-bankruptcy high of $19.75. Its market cap is a paltry $4.4 billion. And it ranked last in a customer-satisfaction survey of its voice and Internet customers released by the Yankee Group in early June.

Potential acquirers such as BellSouth, Verizon Communications, and SBC Communications are circling, though Bell execs say no deal is imminent. To resurrect MCI, analysts say, Capellas needs to stitch together new offerings on the run, such as Internet phone service and videoconferencing. But he'll lots of company. "Everybody is doin ternet convergence," says analyst Hodulik of UBS Securities. "It's r way to [solve] their problems."

How did things get so dire? starters, MCI's grip on the Internet, strong, was far from exclusive. A gl fiber capacity in that market has sent plunging from a median $110 a m last year for a standard business Int connection to $60 a month, accordi telecom consultant TeleGeography search Group. At the same time, MCI ruled much of the dial-up Int market, the mass migration to br band, extending to 33% of U.S. ho holds, saps the company's hold. G that trend, says Jonathan C. Crane, M chief strategist, "you shouldn't be prised our Internet business is declin

RAINY-DAY FUND

CAPELLAS' STRATEGY is to scra into richer Internet businesses befo of the competition arrives. In A 2003, MCI launched its most promi product, a voice-over-Internet p service for businesses dubbed MCI vantage. The product puts MCI ahe AT&T, which so far has only a consu Internet phone offering. But Advan may not attract a customer base till year, says Eric Paula analyst at Gartner Inc

Capellas still has $4.8 billion at last co to tough it out at le year. He's saving by h ing down capital sp ing. Analysts esti that the $880 million will spend this year b reaches one-third AT&T's total. While contends that it spent billion during the boo upgrade its network, constraints on ca spending bode ill the future.

For now, Capellas be sweet-talking tomers and inves working to convince t that MCI's tarnished I net jewel will event shine. A tough sell? MCI's potential pred must be reevaluating.

–By Catherine Ya Washington Brian Grow in At

CAPELLAS Holding down investment

Wheezing Web

Once the crown jewel, business Internet sales at MCI have fallen on hard times:

WEAK INVESTMENT Stymied by its accounting scandal, MCI has slashed investment in its network to $830 million last year, from $6.5 billion in 2001.

SLOPPY SERVICE In a recent survey, customers ranked MCI's network quality, Internet installation rate, and billing efficiency below the industry average. A separate customer survey found that the company rates dead last in overall satisfaction.

DECLINING REVENUES Defecting customers, stiff competition, and falling prices are expected to send revenues from MCI's Internet business down 18% this year, to $1.8 billion.

Data: Skyline Marketing Group, PnMetrica Inc., Guzman & Co., Yankee Group

NBA BOUND Will Howard (left) thrive as a pro?

Helping Teens Make A Big Leap

As more high schoolers get drafted, the NBA is scrambling to smooth their way

CHANCES ARE YOU'VE never heard of Greg Oden. But you can bet that every National Basketball Assn. scout has. Oden is a specimen—a lithe, 7-foot center, 250 pounds and agile, a deft passer on the low post. He also just finished his sophomore year of high school. Scouts say the 16-year-old Indianapolis native could be the first player taken in the 2006 NBA draft—if he wants. For now, Oden says he has other ideas: "I really want to go to college. I want to be a psychologist."

Not many would blame Oden if he puts off grad school. He would hardly be the first high school prodigy to be wooed away from the college ranks by a guaranteed three-year contract worth more than $10 million—and untold millions more in endorsements. Since 1995, when Kevin Garnett skipped college and was selected fifth in the draft by the Minnesota Timberwolves, 22 high schoolers have made the leap. The largest crop ever—as many as 10, led by Atlanta standout Dwight Howard—will enter the league next season after selection at the 2004 draft meeting on June 24.

The influx of teenage millionaires has fundamentally altered the NBA—and may become an issue in labor talks next year. Teams draft on potential, usually investing years of training and millions of dollars in salary before preps develop into stars. Most work out: Of the 22 drafted, only three aren't in the league anymore. Some, such as Garnett and Indiana's Jermaine O'Neal, are among the league's elite. Others, such as Washington's Kwame Brown, the No. 1 pick in 2001, are mere role players so far.

More worrisome to NBA Commissioner David Stern have been a couple of disastrous failures. South Carolina hoopster Taj McDavid declared himself eligible for the 1996 draft, thereby forfeiting his college eligibility. He wasn't nearly good enough to be selected and is now out of organized ball. And Leon Smith, a Chicago high school star, attempted suicide shortly after being drafted in 1999 by the Dallas Mavericks. He has since pieced his life together and was recently invited for some tryouts, but he is thought to be a long shot.

CONSTANT COMMUNICATION

THE LEAGUE IS EAGER to avoid any more such cases—and to help drafted teens through their often-bumpy first years. It has added three extra sessions for players under 20 to its mandatory, year-long rookie transition course, starting even before Draft Day. Mike Bantom, NBA senior vice-president for player development, has increased his staff from 6 to 11 full-time staffers in the past three years. "None of these kids is quite prepared for how hard they are expected to work," says Bantom. "And a lot of them feel alone on the road." His deputy, Chrysa Chin, director of player programs, makes personal visits to each rookie through the year. Trained in social work, Chin advises on matters that 18-year-olds usually don't think about, such as how to pay bills.

In addition, 21 of the 30 pro teams have created staff positions dedicated to young player development. Bill Wennington, a retired NBA center, works with youngsters on the Chicago Bulls, a team that bet heavily on high schoolers when it acquired 18-

Guidance Counselors

Here's how the NBA is dealing with an influx of teenagers:

EDUCATION
An "under-20" component was added to the rookie transition program, with seminars on topics such as stress management and being away from home

ATTENTION
21 of 30 teams have a player development coordinator to look after the needs of younger team members

CONTACT
A league liaison deals with all of the NBA teenagers through out the year, making home visits and keeping in touch via two-way pagers

Data *BusinessWeek*

year-olds Tyson Chandler and Eddy Curry in 2000. "At times [there is] an inability to focus, but it's amazing how much they want to learn," says Wennington. Among his tasks when the Baby Bulls arrived: getting them to stop playing video games until 5 a.m.

The lessons begin even before young players start wending their way up teams' draft boards. Between games at a four-day June camp hosted by the NBA Players' Assn. in Richmond, Va., Oden and 100 other top high school players attended hour-long classes on SAT prep, "sexual decisions," and burnishing the right image. DeNita L. Turner, who owns consulting firm Image Builders Inc., based in Laurel, Md., drilled the kids about how to leave a proper phone message. One high schooler acted out a scene explaining why his name came up in a police investigation. The lesson: Hanging out with the wrong crowd has consequences.

But Dwight Howard's Class of '04 could be the last to make the prep-to-pros leap. The collective-bargaining agreement expires at the end of next season, and Stern is pushing for a 20-year-old age limit. "We're going to be faced with a number of kids taking great chances with their futures," Stern says.

The players, however, won't raise the age limit without a fight because of the oodles of money at stake. Michael McCann, a sports law expert and Harvard Law School visiting scholar, estimates that under the current accord, a player who jumps to the NBA after high school can add as much as $100 million to his career earnings. So the players could demand other concessions in return for an age limit.

And so far, with the NBA's help, the phenoms seem to be handling the pressure—just look at last year's instant superstars, Cleveland's Lebron James and Denver's Carmelo Anthony. According to McCann, teenagers have had a much higher success rate than foreign and collegiate draftees, mostly because they make up a tiny group who have been scouted since the age of 12 for both freakish athletic talent and maturity. True, as Stern says, "there's more opportunity for rocket scientists and brain surgeons than there is for NBA players." But those jobs sure don't pay as well. ■

–By Brian Hindo in Richmond, Va.

BusinessWeek online For a Q&A with NBA Commissioner David Stern, visit www.businessweek.com/magazine/extra.htm

A Spate of Cheatin —by Teachers

No Child Left Behind links test results t school funding. Is that a recipe for decei

EXAM TIM
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IN APRIL, EIGHTH-GRADERS AT Sunset Ridge School in Northfield, Ill., a wealthy suburb north of Chicago, reported a troubling incident to school officials: Someone had changed answers on the math portion of the end-of-the-year state achievement test they had just taken. An inquiry found altered multiple-choice answers on 90% of the tests the school's 80 eighth-graders had been given under the federal No Child Left Behind law. But it wasn't kids using crib sheets or stealing into classrooms to tamper with tests. Instead, suspicion fell on an eighth-grade teacher who denied cheating but promptly resigned, school officials say. (His name hasn't been released, so he couldn't be reached for comment.)

Now the Illinois Board of Education is investigating. And administrators there and elsewhere are worried that even among wealthy, top-performing sch like Sunset Ridge, teachers who are der pressure to show stellar result state standardized tests may be cut corners. "Teachers and administra like rabbis and priests, must be hel the highest standards because we role models for kids," says Sunset R principal Howard Bultinck.

A RASH OF TEST-RIGGING

AS ANOTHER SCHOOL year comes close and results roll in around the c try from new tests mandated by the 2 No Child law, an unanticipated product has arisen: a broad spat cheating—not by students, but by te ers and administrators. From Pittsbu and Milwaukee to Worcester, Mass., Spokane, Wash., hundreds of teacl principals, and administrators been accused of doing anything they to boost their schools' test scores. Tr

essions include changing students' an-
ers on tests, handing out exams—and
en answers—in advance, tutoring stu-
nts with real tests, blocking weak
ıdents from taking exams, and giving
ıdents extra time to finish (table).

The rash of test-rigging is driven large-
by the goals of No Child, experts say,
ıich aims to assess schools, not individ-
l students. The math and English ex-
ıs states must administer don't count
vard students' grades. Instead, they're
-d to judge whether a school or district
making sufficient progress among
ee dozen categories of students, from
ecial-education learners to those with
ak English-language proficiency.

HAT'S AT STAKE

ANY GROUP FAILS for two consecutive
ırs, parents can move their children to
ther school—and districts can lose
ir funding. Eventually, failing schools
ıld close. Some states have taken the
led step of tying financial incentives,
h as teachers' bonuses, to student
res. Since the law's financial penalties
n't fully kick in until 2014, experts say
motivation to cut corners will contin-
to grow. The outbreak is likely to ac-
erate the erosion of public support for
Child, which has been under attack by
nappy parents and teachers ever since
assed. The rising number of incidents
o could further undermine confidence
public schools. "Teacher cheating is
ng because the incentives to do so are
reasing," says Steven D. Levitt, a Uni-
sity of Chicago economics professor
o co-authored a recent study of
cher cheating on standardized exams.
The problem has sharply divided ex-
ts, who tend to be polarized about the
Child law anyway. Proponents say
ım scofflaws are part of the price of an-
al testing, which shows parents how
ll a school is really doing, and dismiss
notion that accountability itself is the
blem. "It is simply a disgrace that a
all minority of teachers feel the need to
at and are blaming their own moral
lings on No Child Left Behind," fumes
ucation Secretary Rod Paige in an e-
iled statement to *BusinessWeek*. "Why
t just say: 'The devil made me do it?'"

Critics, however, see the cheating as
nfirmation of their negative view of the
v. Holding teachers and schools re-
onsible for the results of one annual
t, they argue, distorts the yearlong
rning-and-evaluation process that
es place in the classroom. "In re-
onse to bad policies, teachers and
ools will do bad things," says Monty Neill, executive director of the National Center for Fair & Open Testing in Cambridge, Mass., which argues that No Child misuses standardized tests, hurting minorities in particular.

Some point out that even Houston's school system, the model President George W. Bush used to draw up the law, now faces civil lawsuits because of allegations that it boosted the city's test scores by excluding dropouts from the results. Houston's schools were headed part of this time by Paige, whom Bush brought to Washington largely because of the school performance that now looks exaggerated. Paige says he stands by his record in Houston.

PAIGE Test-rigging by schools is a "disgrace"

Because the law is still so new—schools aren't required to have all their tests in place until next year—no one really knows how widespread the finagling has been. In Chicago, about 5% of the system's 40,000 classrooms had seen some cheating since the city stepped up No Child-style standardized tests in 1996, according to a 2002 study by Levitt and Harvard University public policy professor Brian A. Jacob. Now the No Child law may prompt more cheating, both in Chicago and across the country, since the federal law carries more financial penalties for teachers and schools, say experts.

Certainly, the end-of-school exam season has turned up plenty of outrageous incidents. In mid-June, a Boston elementary school principal was suspended with pay after a group of fourth-graders and their teacher alleged that she encouraged the students to cheat on the state test. In California, a May review of public records by the *Los Angeles Times* turned up more than 200 teachers who have been investigated for cheating since 1999. Many of the incidents involved schools with large minority populations, where test results often fall below the state minimum.

In some schools, students even seem to assume that getting help on the test is O.K., since their teachers are offering it. In May, Washington State reprimanded a fourth-grade instructor at Longfellow Elementary School in Spokane after she showed students answers to the math portion before they took the state exam last year. The teacher also coached some students and allowed others to share answers during the actual exam. She resigned last August, shortly before district administrators filed a complaint with state officials. (The teacher couldn't be reached by *BusinessWeek* for comment.) But when investigators looked into the incident, they found that one child wrote "my techre told me" in a section that required students to show their work, according to the state's Office of Professional Practices.

A handful of states and districts are cracking down. At least four state legislatures—Michigan, Louisiana, Virginia, and Nevada—have passed laws to combat teacher meddling, according to the Education Commission of the States, a Denver-based nonprofit. And Pittsburgh education officials recently began placing independent monitors in each school after several cheating incidents. Still, given the tremendous pressure No Child is putting on schools and teachers, test-rigging isn't likely to stop soon. That's particularly unfortunate given the poor example it sets for any child who sees it. After all, when teachers cheat, they give students a lesson for life. ■

–By Brian Grow in Atlanta

How **Not** to Boost Scores

The No Child Left Behind Act mandates student testing, the results of which are used to judge schools' progress. And in some places that progress, or lack thereof, is tied to teacher and administrator pay, prompting a spate of cheating charges around the country. Some examples:

CHANGING ANSWERS Teachers in California, Illinois, and Michigan have altered students' answers by erasing them or filling in unanswered questions

COACHING DURING EXAMS Instructors have helped students with their No Child tests in Massachusetts, Nevada, and Washington

HANDING OUT TESTS IN ADVANCE Cases of this have occurred in Pennsylvania and Wisconsin, among other states

NOT COUNTING WEAKER STUDENTS To boost school test scores, dropouts and special-education children have been excluded or not counted in New York, Tennessee, and Texas

Data: Brian A. Jacob and Steven D. Levitt, *BusinessWeek*

Drug Cards: Who Will Win the Pot?

Seniors are flummoxed—but insurers and distributors see a ripe opportunity

THE MEDICARE DISCOUNT drug card that seniors began using on June 1 has left millions of retirees disappointed and confused. But the story is very different for the companies offering the cards. Players of every description are scrambling to get a foothold in the new business Congress created when it passed the Medicare prescription drug law last year.

In recent weeks, dozens of companies have rolled out more than 70 government-approved cards as they pitch for seniors' business. Insurance companies, drugstores, drugmakers, and distribution middlemen called pharmacy benefit managers (PBMs) have all jumped in.

Their goal isn't a big short-term profit; many may actually lose money by offering a card that will go out of existence in just 18 months. A lot of the other players are simply fighting a rear-guard battle to defend themselves in the crossfire. But for everyone, the focus is on 2006, when the card, which provides only limited discounts that companies decide to offer, is due to expire. At that point, it will be replaced by the potentially more lucr drug insurance that Congress agre fund, which will pay a set proporti seniors' drug costs. "The key is for sponsors to position themselves for says Vicki Gottlisch, a lawyer at the profit Center for Medicare Advocacy

The biggest winners may be insu and PBMs. Their strategy: Use the c to build a roster of customers they switch to drug insurance in 2006. Th losers may be the pharmacies, since s discounts will come out of their mar As for Big Pharma, drugmakers may more pills, but they may have to ab slightly lower prices as well.

SHORT SHELF LIFE

AT FIRST GLANCE, the rush to offer might seem strange. Sponsors must sorb startup costs for a product wi limited shelf life. And competition i tense. The Congressional Budget O expects only 7 million of the nation' million seniors will buy a card— many to divide among 72 different ca And with so much confusion, early rollment has been slow.

Partly to hedge their risks, spon have put together a bewildering ma partnerships and joint ventures. Take PBMs, which negotiate prices dir with manufacturers. Companies suc Express Scripts, Caremark Rx, and M Health Solutions already offer Medicare drug discount cards thro employers and insurers. But for Medicare cards, they want to publ their own brands. So Medco, for ins has its own Medicare card—even handles price negotiations for sev managed-care companies, including ant UnitedHealth Group Inc., which Medicare card of its own. Confused y

United, a Minneapolis health insu is putting out its own card, too. But, other insurers, it's also partnering

The Brawl over Medicare's Discount Card

On June 1, 44 million seniors became eligible for federal drug-discount cards. The cards expire in 2006, when a new Medicare drug insurance program begins. Meanwhile, the competition is fierce.

INSURERS AND DISTRIBUTORS Companies such as UnitedHeal and Medco, a drug wholesaler, are teaming up to market cards. Although they don't expect to make much money, they hope to lock in customers whom they can convert into their insurance networks in 2006.

PHARMACIES The card may bring in some new buyers, but because most discounts are coming out of drugstore profits, it may batter margins. Pharmacies also worry that the card will drive more seniors to mail-order purchases.

DRUGMAKERS The likes of Merck and Pfizer hope the cards will help sell more pills without cutting too deeply into their margins

ers, such as the senior advocacy group RP—just in case retirees prefer some-e else. United has yet another card led U Share, which is a venture with zer, Eli Lilly, and other drugmakers. wonder seniors can't make heads or ls of what's going on.

KING A LONG VIEW

EW PLAYERS HAVE niche strategies, nough they, too, are aiming at 2006 and ond. First Health Services Corp., a n Allen (Va.) management company, s six state programs that already pro-e discount drugs for low-income peo-. Because Congress agreed to pay for 00 in free drugs through the Medicare d for many of these same seniors, First alth is offering its card to more than),000 elderly in three of those states—chigan, New York, and Pennsylvania. e payoff: The Medicare law allows se low-income seniors to be automati-y enrolled in a card—and First Health negotiated to sponsor it. That will help ition First Health with these cus-ners for 2006, says CEO Teresa DiMarco.

The companies with the fewest options y be the pharmacies, especially the mom-and-pop drugstores that still sell 44% of all prescription drugs in the U.S. Until now, many retirees were buying medications from them at retail. Now, drugstores have had to negotiate lower prices with card sponsors or risk losing those customers entirely.

The cards also make it easier for seniors to order drugs through the mail. This fattens margins for PBMs but drives customers out of pharmacies. Not only do druggists lose sales, but purchases of other products—from sunscreen to pantyhose—also shrink. "They count on the pharmacy to drive traffic into the store," says Deborah Martin, co-manager of the managed pharmacy practice of Mercer Human Resource Consulting.

Giant drug chains may not suffer much. Not so for mom-and-pops

The giant chains may fare somewhat better. For example, 4,397-store Walgreen Co. is offering its own card, not just for its stores but for 36,000 other pharmacies around the country. Why would independent pharmacies accept a card from a giant rival? They have little choice but to take nearly any card a senior carries. True, they will have to swallow the lower price set by Walgreen Co. or any sponsor. But if they don't, retirees may take their business elsewhere.

Big Pharma faces trade-offs, too. Volume may rise as seniors buy more drugs. But margins may be squeezed once the drug insurance kicks in. If millions of seniors buy the coverage, insurers will gain added negotiating clout to push prices down nationwide. By 2008, "the volume-price trade-off will be a wash [for drugmakers]," says Richard Evans, an analyst at Wall Street firm Sanford C. Bernstein & Co.

The post-2006 business will be no slam-dunk, even for PBMs and managed-care companies. But the chance to grab a share of the booming seniors market is a temptation few are willing to pass up. That's why so many companies are trying to get on the inside track by offering cards today. Unfortunately, that means a migraine-inducing muddle for seniors. ■

–By Howard Gleckman in Washington

Radio Days

Vintage wireless sets are gaining popularity among collectors, and there are plenty of bargains if you know where to look. **BY GERRY KHERMOUCH**

FOR SOME COLLECTORS, the first primitive radios are the lure—old breadboards covered with vacuum tubes, capacitors, and wires assembled in the early decades of the 20th century. Others see value in brilliant, exotically colored plastic models of almost fluorescent intensity, cast in the 1930s into miniature architectural forms.

At a time when mass communications have come to pervade every aspect of our lives, it's not hard to see the fascination of early contraptions built to transmit the human voice—whether old Emerson or Grebe radios or the bulky Marconi wireless sets like those hauled by Admiral Richard E. Byrd on his expeditions to the South Pole. Judging by a surge in prices, auction activity, and museum openings, antique radio collecting has taken off in the past few years, with the ranks of the obsessed extending from retired broadcasters and Microsoft millionaires to doctors, dentists, and design-dazzled young urbanites. For a few thousand dollars, you can embark on a fascinating quest that, if you're shrewd about it, could end up paying for itself many times over

It's easy to get started, thanks to the growing number of radio clubs and swap meets—and eBay. John V. Terrey, a retired Raytheon executive who publishes the monthly *Antique Radio Classified,* figures there are 20,000 to 30,000 serious collectors. Newcomers are often established businesspeople with a little more time and money on their hands—such as Eric P. Wenaas of Delmar, Calif. Upon retiring two years ago at age 58, after the sale of his defense services business, he began haunting swap meets—and then eBay—to reconnect with a childhood interest in crystal radios. Now he boasts a collection of 400 American crystal sets, nearly 400 French crystal sets, and more than 500 RCA Radiola sets from the 1920s. A new home he's building will have a gallery to display his collection.

BusinessWeek online For a look at the different radio styles over the years, go to www.businessweek.com/magazine/extra.htm

WWW.RADIODAZE.COM

TUNING IN

SERIOUS RADIO COLLECTING began in the early 1960s with the formation of the Antique Wireless Assn. What gave it a big push was a massive auction by the Henry Ford Museum in 1995, when a 1913 Marconi tuner fetched $49,000. That prompted a flow of rare pieces to the market. Interest hit a crescendo in August, 2001, at an auction of the 3,000-piece collection of the late Ralph Muchow, an Elgin (Ill.) dentist. Proceeds topped $1 million, including the auctioneer's 5% premium. Among the prizes: a 1928 receiver taken by Admiral Byrd to the Antarctic, at $33,500. Although Estes Auctions now conducts radio sales monthly or more, the market remains fragmented. That makes it harder to get a read on values but ensures that diligent collectors can still sniff out bargains.

Do some prep work before taking out your checkbook. For $39 a year, you can subscribe to *Antique Radio Classified* (antiqueradio.com) for articles, listings, and access to a Web site with links to local wireless groups, collectors, and museums. Seek out other collectors, perhaps by catching a meeting of a local radio club. If

visit a swap meet, wake up early: Of- flashlight-wielding collectors start king the car trunks full of merchandise 4:30 a.m. and the choice items may be e before 7 a.m. And try to visit one of museums that have sprung up— ably, the American Museum of Radio Electricity in Bellingham, Wash. vw.americanradiomuseum.org). That's re retired Microsoft executive John kins has combined his early radios with Golden Age items of a collector named athan Winter, as the initial step of a million plan to build it into the coun- s top collection. "I spent too many s trying to approach world domination" in the software business to go easy on a radio hobby, jokes Jenkins, who retired in February, 2001, at age 52.

So what's hot these days? Auctioneer Richard Estes sees three sweet spots with appeal to different audiences. Wireless sets from early in the 20th century, sold under brands such as DeForest, Marconi, and Western Electric, draw an older, often techie crowd, and command top prices routinely exceeding $30,000. Coming on strong in recent years have been amateur "ham" radios, which appeal to those who enjoy poring over circuit diagrams.

Then there are the plastic sets, which consist mainly of colorful tabletop radios manufactured in the 1930s and 1940s. They are back in vogue among younger collectors with retro design sensibilities. "You can go in for aesthetics or for the historical significance of the circuitry, which is boring and ugly," says Charlotte Mager, co-proprietor of Waves, a New York antique radio retailer.

Most valued among those are radios cast from phenolic plastics sold under trade names like Bakelite or Catalin and once manufactured by companies such as Emerson, Air King, and Fada. Catalin radios boast brilliant colors, but the material was prone to discoloration and cracking. For that reason, certain models in good condition are hard to find and may bring prices that exceed $30,000. Other Catalin sets can be obtained for only a couple of hundred dollars and make for great conversation pieces.

Although you should always enter a hobby for love rather than profits, savvy collectors have done pretty well since the 1990s. But you have to buy the right stuff. While some collectors are happy to accumulate breadboards, vacuum tubes, and controls, more mainstream collectors are looking for finished items, so concentrate on these. Many but not all collectors want radios that work. Be alert to the "collectibility" factor, whether it's historic value or the inherent aesthetic appeal of the cabinetry of tabletop Cathedral-style or Art Deco radios from the 1930s or the pedigree of a great industrial designer like Walter Teague. Jenkins says he is stunned at how a Marconi receiver from the 1910s, available for a few hundred dollars a decade ago, now may command $15,000.

Even if you don't make out like that, collecting radios has its rewards. It lets you amass some fascinating building blocks of the media-saturated world that we all take for granted.

SCOTT PHILHARMONIC This 1940s Gothic cabinet was the focus of family entertainment

You're All Ears

Pay heed to the aspects of radio that interest you—whether it's electronics or aesthetics

1924 RCA Sarnoff Speaker
This museum piece was built for the boss by Czech artisans

1910 Marconi Tuner
One collector calls this "the ultimate in early wireless"—valued at $50,000

1930 Philco 20
Table model shown at the American Museum of Radio & Electricity, in Bellingham, Wash.

1946 Fada 1000 Radio
The appeal of early plastic household sets lies in their bright colors and sleek styling

(TOP TO BOTTOM) THE AMERICAN MUSEUM OF RADIO AND ELECTRICITY/WWW.AMERICANRADIOMUSEUM.ORG(3); ©CLASSIC RADIO GALLERY.COM

How to Find The Fittest IPOs

Here's a formula to help you figure out the long-term prospects of a hot offering. **BY ANNE TERGESEN**

AS INVESTORS CHASED initial public offerings in the late 1990s, they concocted some odd ways to gauge the prospects of companies with lots of buzz but little or no profits. Among the wackiest: the "eyeball ratio," calculated by dividing a company's projected market capitalization by the number of visitors to its Web site. Now, with big names such as Google planning to go public and with the overall number of IPOs rising, after a three-year drought, is there a better way to figure out whether today's hot new stock is more likely to become a runaway success like eBay or a dog like Pets.com?

A recent academic study suggests it's possible to boost your odds of picking IPO winners and avoiding losers. The secret is a formula that draws on common financial data, such as revenues, return on assets, and debt. Nearly all the information you need is in the S-1 statement that panies are required to file with the rities & Exchange Commission befor ing public. "It's a relatively simple that individual investors can use," Wayne Shaw, professor at the Cox S of Business at Southern Methodist versity in Dallas, who developed it Steven Henning, a former Cox prof who is now a director at accounting Marks Paneth & Shron.

By screening out the IPOs likely the worst performers, Shaw says model, applied to 3,941 IPOs filed tween 1995 and 2001, earned retu year later akin to those of a similar folio of already-public small-cap st That's a big deal, given the strong dency of IPOs to lag after the initia phoria wears off. In contrast, those that the model labeled losers tr peers by more than eight percen points a year after going public. (Bec it's hard for individual investors to IPO shares at the offering price, S measures returns using the price a end of the first trading session.)

HITTING PAY DIRT

WHY INVEST IN IPOs at all if, on a age, winners fare no better than the

lished peers? For one thing, there's ays the possibility you might pick the t Microsoft or Cisco Systems. But n without a big hit, a basket of IPOs cted by the model should outperform Standard & Poor's 500-stock index hree to four percentage points a year ompensate for the higher risk level, Shaw.

f course, no formula is foolproof. m 1998 to 2001, the accuracy rate of w's model ranged from 56.6% to %, depending on the year. As a result, isky to use it to forecast the success of one IPO. But if you're willing to ad your money among a diversified folio of new issues from a cross-sec- of industries, you just might hit pay . The model "plausibly separates panies that are less likely to do poor- the long run," says Jay Ritter, a fi- ce professor at the University of Flori- vho studies IPOs. Still, he adds, "no en is necessarily going to work in any n quarter or year."

Moreover, the model doesn't take mar- valuation into account. But you ld. If an IPO starts trading more than above its offering price, steer clear. A den big rise, Shaw explains, suggests the good news is already priced in."

It's also a bad sign when a stock starts trading below its offer price, since this indicates demand is soft.

You have plenty of opportunity to test-drive Shaw's model. Through June 18 this year, 171 companies have filed to go public, the most since 2000, says Thomson Financial. But as the market heats up, so does risk. "When everyone is filing to go public, you get many more dogs completing IPOs," says Shaw. "This is a time when investors could get burned."

What are some good bets? The model likes Google, Domino's Pizza, and the electronic stock exchange, Archipelago. Among the pans: nutritional-supplement retailer GNC (table).

LOTS OF NONSTARTERS

SOME COMPANIES NEVER even get into the screen. Shaw excludes financial companies: Their financial structures don't work with his method. He also disqualifies companies expecting to raise less than $1 million, as well as offerings priced below $1 a share. "They're the most speculative," he says.

Then, he looks in the company's S-1 filing for the nine inputs the model needs to make a recommendation (table). The next step: Multiply the nine by the coefficients that give the data the proper weighting in the formula, and add the results. As a general rule, if the sum is below +0.5, the company's a good bet. Shun the deal if the sum is above +0.5. Obviously, the closer the outcome is to 0.5, the less clear the argument is for buying or avoiding a stock.

Try Shaw's formula on the Google deal. Start with its return on assets—calculated by dividing the company's 2003 profits of $105 million by its $871 million in assets. Both numbers (and it's important to take the annual ones) are listed in the amended registration statement Google filed with the SEC on May 21. The answer, 12.1%, gets input as 0.121. Next, move to debt. This figure, measuring long-term debt as a percentage of total assets, is 3.8%, or 0.038.

Another input, "price range," looks at whether the company disclosed a price range for its stock. The idea, says Shaw, is to gauge how complete the prospectus is: "The less complete, the more risk," he says. Indeed, according to Shaw, 98% of successful IPOs included a price range in the initial filing, compared with just 70% of the losers. Because Google did not specify a range, enter zero here. If it had, you would enter a 1. (In fact, if Google had done a conventional offering instead of a Dutch auction, it might have lised a price range.)

If the company changes its price range, put a 1 next to "change in range"—regardless of whether the price rises or falls. In the case of an increase, pencil in another 1 next to "increase in range." This suggests strong demand for the stock—a plus in calculating a score.

The final pieces of the puzzle—the company's revenue, age, the offering's projected proceeds, and the underwriter's rank—have to be adjusted so they don't disproportionately influence

Pending IPOs that the model **likes...**

- Archipelago
- Domino's Pizza
- Google
- Hyland Software
- Lumera
- Mone Wireless
- Neurometrix
- New River Pharmaceuticals
- Texas Roadhouse
- Volterra Semiconductor

...and some it **doesn't**

- Accent Optical
- Brightmail
- eCost.com
- GNC

Data: Professor Wayne Shaw, Cox School of Business, Southern Methodist University; Steven Henning, director, Marks Paneth & Shron

Is This IPO a **Good** Deal?

Two financial researchers devised a mathematical model to predict whether an IPO would succeed or fail. You multiply common financial metrics such as revenue and return on assets by a coefficient, which weights the data in the formula. Then total your answers. A score of less than +0.5 means the IPO is attractive; above +0.5 raises red flags. Here, we've run Google through the model. Its score of -1.02 means the Google IPO passes this test.

	DATA	X	COEFFICIENT	=	RESULT
Revenue	6.868*	x	-0.213	=	-1.463
Return on assets	0.121	x	+0.231	=	+0.028
Long-term debt/assets	0.038	x	+0.725	=	+0.028
Underwriter ranking	10.938*	x	+0.237	=	+2.592
Age of company in months	4.249*	x	-0.151	=	-0.641
Offering proceeds	7.901*	x	-0.198	=	-1.564
Price range	0**	x	-0.306	=	0.00
Change in range	0**	x	+0.129	=	0.00
Increase in range	0**	x	-0.224	=	0.00
			SCORE	=	-1.02

*To calculate these data points, take the company's revenues and projected offering proceeds, remove the millions so that $916 million becomes 916. Enter them into a financial calculator or an Excel spreadsheet, and use the natural logarithm function. You need to calculate the underwriter's market capitalization, too, removing the millions as well. We used Morgan Stanley's market cap here. No adjustment is needed for age of company in months before calculating its natural logarithm. **0 means there's no price range, change, or increase; enter 1 if any of these occur.

Data: Wayne Shaw, professor of corporate governance, Cox School of Business, Southern Methodist University; Steven Henning, director, Marks Paneth & Shron

the result. First, divide the millions and billions by a million. So Google's $961 million in revenue becomes 961, and its $2.7 billion of projected proceeds become 2,700. Then put those numbers through the logarithmic function in Excel or a financial calculator. Using a "natural logarithm" formula, Google's $961 million in revenue is 6.868, the $2.7 billion "proposed maximum" offering price is 7.901, and 70, the company's age in months, is 4.249.

"Underwriter ranking" rates the lead investment bank underwriting the offering by its market capitalization. Google's backers—Credit Suisse First Boston and Morgan Stanley—both have large market caps. Use the natural log formula here, too. Why is this important? "It's a way to measure risk," says Shaw. For example, "a Goldman Sachs is not going to take on a dog and risk its reputation. But a known underwriter trying to break the market may."

The verdict on Google? A thum with an overall score of –1.02. Th course, doesn't tell you how muc should pay, but at least now you whether it's worth your time even co ering the question. And it's probabl more useful than the eyeball ratio.

Security

Bike Locks that Mean Business

New ways to thwart thieves. **BY KATE MURPHY**

BIKING SEASON IS HERE, and that means bike thieves are out in full force. Many cyclists resort to "dorking" or "distressing" their bikes by painting them pink or wrapping them in electrical tape to make them less attractive to crooks. Still, the best way to prevent theft is to lock up your bike—even if it's in your garage.

The kind of lock you buy depends on where you park. If it's in a heavily trafficked area, you can probably get by with a good braided-steel-cable lock or U-lock for $18 to $30. But if you leave the bike overnight or off the beaten path, you'll need something more substantial. Kryptonite's Fahgettaboudit ($120) and Master Lock's Street Cuff SS ($125) are among the most theft-resistant. "You'd need serious power tools to get through either one of those," says Beth Annon, owner of B&L Bike Shop in Davis, Calif.

The Fahgettaboudit is a double deadbolt lock attached to a three-foot chain with 11-millimeter hexagonal links that can withstand 16 tons of force. It weighs just over 8 pounds, so you wouldn't want to take it on long rides. More likely, you would leave it hitched to the rack where you frequently park your bike. The Master Lock Street Cuff SS is 5.5 lbs. and looks like a police handcuff. It's intended for motorcycles but works as we bikes. If thieves manage to foil eith Fahgettaboudit or Street Cuff, the m facturers will replace your bike, up value of $3,500.

SQUEALING

IF YOU'RE WORRIED about losing saddle and wheels, Veratomic, Pi and Kryptonite offer locking skewe that cost $35 to $50. These nifty de work like regular skewers—those pin-like fasteners that keep your sea wheels attached to your frame—e they have a little lock you turn with

For added protection, consider o the new bike alarms. The tiny ba powered Cy-Curity alarm ($50; cy ty.com) fits out of sight under your seat and is triggered by a motion se It comes with a remote control so yo make it start or stop howling at will

Finally, for $10, you can register bike with nationalbikeregistry.com, s police can trace it to you if they reco after it's stolen. You'll receive a ta proof I.D. sticker that shreds if thiev to remove it. A shredded sticker is flag to potential buyers, making th at least as difficult for crooks to res one that is painted pink. ■

Ounces–and Pounds–of **Prevention**

KRYPTONITE SKEWERS

$35-$50

These metal pin-like fasteners secure your bike's saddle and wheels—and require a key to open

STREET CUFF SS

$125

You would need serious power tools to break these—meant for a motorbike

FAHGETT-ABOUDIT

$120

Weighing more than eight pounds, this baby has a double dead-bolt lock and a three-foot chain

ITED BY TODDI GUTNER

ETAILING

VHERE PHONE ERVICE IS WARM ND FUZZY

HERE ANYTHING more frustrating than ling with a customer service resentative who is unhelpful or rude? find out which U.S. retailers have the t telephone reps, Boston consultant **bar** grilled the people who answered phones at the 21 largest companies on ics such as product information, urn policies, and warranties. The les below rank the retailers in order he quickest to respond and the ndliest reps. The findings are based on s made in February and March, 2004.

ST RESPONSIVE REPS	FRIENDLIEST REPS
Lowe's	1. L.L. Bean
Best Buy	2. Circuit City
Gap	3. Lowe's
QVC	4. Best Buy
Circuit City	5. J. Crew

ta: Dalbar

OSMETICS

EGGIES O THE RESCUE

A FAST-GROWING British retailer of soaps and shampoos is giving new meaning to the term "fresh beauty." **Lush,** which plans to open 15 U.S. stores this year for a total of 19 e (and 185 worldwide), uses fresh its and vegetables in its products and mps an expiration date on many. Its Fresh line features masks and scrubs .95 to $9.95) that need refrigeration l spoil after three weeks. The After go foot cleanser ($7.65) uses "cooling cado, skin-softening almond oil, and pain-relieving properties of aragus." Bet it would make a nice d, too. *–Christopher Palmeri*

TRUSTS

Guard That IRA

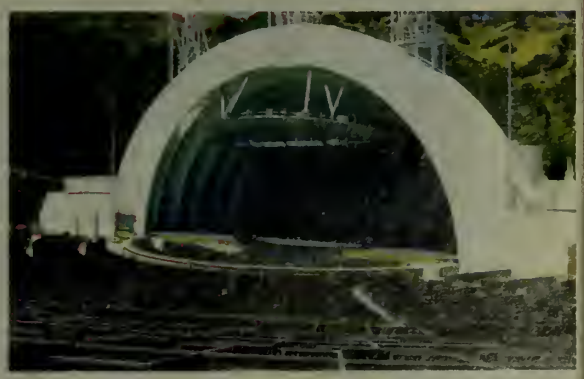
TRUST FUND BABIES BEWARE. A recent **Internal Revenue Service** regulation may make you poorer. The rule could affect you if part of the payout from the trust comes from an individual retirement account. Traditionally, many trustees counted the entire annual required minimum distribution (RMD) from an IRA within a trust as income for the beneficiary. But the **IRS** has sided with 40 states that want to slash that payout to just 10% of the RMD, unless otherwise specified. That means the other 90% would stay within the trust, where it can get taxed at a federal rate as high as 35%.

An IRA owner can fix the problem by making sure the trust specifies that 100% of the RMD should be income to the beneficiary, says Seymour Goldberg, a Melville (N.Y.) trust and estate attorney. But if the IRA's original owner is deceased, a solution isn't so easy. While many states give trustees ways to alter payouts, disputes may arise between beneficiaries, says Ed Slott, editor of **Ed Slott's IRA Advisor** newsletter. Kids from dad's first marriage might rather see stepmom's income cut, leaving more in the trust for them. *–Carol Marie Cropper*

(CLOCKWISE FROM TOP): ILLUSTRATION BY ANTHONY RUSSO; PHOTOGRAPH BY LAWRENCE ANDERSON

TIME OFF

THE HOLLYWOOD BOWL opens its season with a bigger, acoustically improved band shell, its first new one in 75 years. Besides the Los Angeles Philharmonic and Hollywood Bowl orchestras, the 18,000-seat outdoor amphitheater will feature performances by the Joffrey Ballet, B.B. King, cancan dancers from the Moulin Rouge in Paris, Harry Connick Jr., and k.d. lang. On 16 nights the concerts will end with fireworks. Tickets start at $1 and $3 and top out at $106; shows run through Sept. 21.



BY ROBERT BARKER

What's Redstone's Game at Midway?

Octogenarian Sumner Redstone is into games—video games, that is—"the hottest part of the entertainment industry," he told me the other day. That, plus a comeback at producer Midway Games, explains why the Viacom CEO this year more than doubled his stake in Midway, to 74%. "Add turnaround to industry growth—that means 'buy' to me," he said.

To Redstone's fellow investors in Midway, however, his enthusiasm may wind up meaning "sell." Redstone is exploring a buyout of the minority shareholders. He stresses this is just one option. Yet the prospect inevitably raises the question: At what price? Any buyer naturally wants to pay as little as possible. But if you're a seller who is being asked to give up your share of the future, you would want to get the most you can in return. Finding a fair price would probably fall to a special committee of the board. That group, in turn, might rely on Wall Street bankers who, for a fee, would estimate the company's true value. All this is getting dicier as regulators, including the Securities & Exchange Commission, scrutinize how such opinions are solicited and rendered, fearing that conflicts of interest may benefit majority holders over minorities. In this climate, the Midway board may soon have its hands full.

TO SEE WHAT I MEAN, first note that Midway's new strategy—of focusing on fewer games, but better-quality ones, such as 2004's *NBA Ballers*—has it expecting a 60% jump in 2004 revenue (charts). The future promises more gains. With consumers TiVo-ing out TV ads, games may emerge as alternative ad venues. Shari Redstone, Sumner's daughter and Midway's vice-chairman, explains: "Unlike television, you know they're glued to their screen."

Valuing this potential would be up to the Midway board if Redstone makes a bid. The market price for the minority shares is $225 million, but presumably Redstone would have to pay more. Now, examine Midway's board. This spring, as Redstone's stake topped 50%, he got Midway to its board from 11 seats to 8, including one for his daughte Another new director, Kenneth Cron, was CEO of Vivendi Universal Games until January, when Vivendi installed ne management. In April, he became interim CEO of Comput Associates International. In May, Redstone nominated hir Midway's board, and on June 14, Cron became chairman. third new director is Joseph Califano Jr., president of the National Center on Addiction & Substance Abuse and a director of Viacom, Redstone's chief holding.

NBA BALLER Hot new tit may make sales jump

Four Midway board veterans—Harold Bach Jr., William Bartholomay, Louis Nicastro, and Ira Sheinfeld—also serv directors of gambling-machine maker WMS Industries, wi until 1998 was Midway's parent. Redstone holds nearly 30 of WMS. Also, WMS and Midway are clients of Bartholom and Sheinfeld's insurance and law firms, respectively. Sha Redstone declined to discuss how the board might evalua bid from her dad; the other six did not respond to my calls

That left Robert Waxman, a New York accountant, who clined comment. Redstone said: "No stockholder of any company in which I'm involved would be treated worse th me and probably better.... If the person who controls the company wants to protect its stockholders, he can do that only minorities could always simply trust the majority. ■

E-mail: rb@businessweek

BY DAVID HENRY

WHY THE YELLOW PAGES MAY SPELL GOLD FOR R.H. DONNELLEY.

ASHLAND LINES UP A WINDFALL TO PLOW INTO CHEMICALS.

MALPRACTICE POLICIES PAY OFF FOR AMERICAN PHYSICIANS.

ind It Fast at Donnelley

S THE ONLY PUBLICLY TRADED U.S. publisher of phone book yellow pages, R.H. Donnelley (RHD) generates as little interest on Wall Street as any thick, book. Publishing revenues grew only 0.2% in 2003. This , reckons Thomson First Call, ings will climb just 11%, to $2.85 a e, despite the economic recovery. se, the market expects that as dband spreads, fingers will quit g the walking and start clicking on search engines. But in Donnelley's k of business, you'll find a pelling story, says Mark Bacurin of kers Robert W. Baird. The stock is his target is 56 in a year. The ment: Donnelley's salesforce is d into steady ad revenues—from nbers, roofers, and carpet cleaners. In contrast, Net giants strong on national accounts. Donnelley can grow by acting local sales agent for Web biggies, says Bacurin. The pany says it's exploring a wide range of commercial ngements with Net companies. Greg Sterling, a yellow es analyst at Kelsey Group, says Donnelley's dominance in ocal markets is a valuable asset to online outfits. The stock eap, says Bacurin. Its price-earnings ratio, based on 2005 ings estimates of $3.14 a share, is 30% below those of spaper and marketing-services stocks. The discount based ash flow is more, at 50%, because its depreciation and rtization expense overstates its need for capital spending.

CHEAP AT THE PRICE

Data: Bloomberg Financial Markets

shland Could Rise ke a Phoenix

VERY CHEMICAL COMPANY needs a good catalyst. Ashland (ASH) is getting one in the form of $2.7 billion in cash. The money, expected late this year, will come n a sale to Marathon Oil of its 38% stake in their joint ure, Marathon Ashland Petroleum. Ashland, after paying all ebts, will have $770 million left to seed growth in specialty nicals. Ann Kohler of Independent Research Group says the lt will transform this amalgamation of oil, chemicals, and building into an attractive growth story with stronger cash s and a higher valuation. Her target for the stock is 66, d, conservatively, on $770 million plus a valuation of its ing businesses at eight times 2005 earnings before interest, taxes, depreciation, and amortization of $8 a share. Better returns from investing the cash would drive the stock higher. The shares have already climbed from 44 four weeks ago to 52 as the market has warmed to the prospect. One risk is the Internal Revenue Service might say the deal can't go off tax-free. That could kill it. But Robert Willens, tax expert at Lehman Brothers, says that as complex as the deal is, it meets IRS tests.

UP, UP, AND AWAY?

Data. Bloomberg Financial Markets

ACAP: The Headaches Die Down

MEDICAL MALPRACTICE SUITS are a pain—except for lawyers and winning plaintiffs. Insurer American Physicians Capital (ACAP), however, is coping nicely. Premium rates are up more than 20% for the third year. Now underwriting losses are falling—fattening the bottom line. Richard Pzena, whose Pzena Investment Management owns 15% of the stock, says earnings will nearly double, to an annual $4 a share, by fourth quarter, 2005. ACAP earned 56¢ in the quarter ended Mar. 31. The surge should lift the stock from 23 to 40, even with no improvement in ACAP's p-e of 10, says Pzena. The premium hikes, allowed by state regulators, are sticking. The company is renewing about 85% of its policyholders. At the same time, claims and payouts for jury awards and settlements are falling. The average award is down from $82,200 six months ago to $55,200. ACAP is withdrawing from business in Florida and Nevada, where underwriting losses were swamping premium income. Michael Dion of Sandler O'Neill has a hold on the stock because of the chance that losses could turn up. Meanwhile, the company has conservatively raised reserves to $95,400 per claim.

FEELING MUCH BETTER

Data. Bloomberg Financial Markets

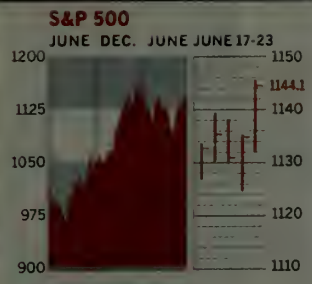
Gene Marcial is away for several weeks.

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/ today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays. See Gene on Fridays at 1:20 p.m. EST on CNNfn's *The Money Gang*.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

Personal Business Figures of the Wee

STOCKS



COMMENTARY

Stocks inched ahead last week as investors held their breath in anticipation of the Fed's June 29-30 meeting. Another beheading in the Middle East dampened sentiment, too. The Dow, NASDAQ, and S&P 500 each eked out a roughly 1% gain. In a promising sign for the IPO market, Salesforce.com gained more than 56% in its market debut Wednesday.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	JUNE 23	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1144.1	0.9	2.9	16.5
Dow Jones Industrials	10,479.6	1.0	0.2	15.5
NASDAQ Composite	2021.0	1.1	0.9	25.5
S&P MidCap 400	602.0	1.1	4.5	26.4
S&P SmallCap 600	290.8	1.8	7.5	34.0
Russell 3000	648.0	1.0	2.8	18.1
SECTORS				
BusinessWeek 50*	657.9	0.8	5.8	12.6
BW Info Tech 100**	345.0	0.8	-1.6	12.4
S&P/BARRA Growth	569.6	0.7	2.5	14.0
S&P/BARRA Value	570.2	1.2	3.3	19.1
S&P Energy	254.8	2.8	13.7	28.3
S&P Financials	385.7	0.7	1.5	16.3
S&P REIT	119.7	2.7	3.4	21.2
S&P Transportation	203.9	2.1	1.0	15.1
S&P Utilities	121.1	2.2	2.2	6.8
GSTI Internet	163.5	1.9	13.0	39.4
PSE Technology	720.2	1.2	3.3	28.0

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	JUNE 23	WEEK	% CH YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1172.8	0.4	-0.5
London (FT-SE 100)	4486.7	-0.1	0.2
Paris (CAC 40)	3720.1	0.2	4.6
Frankfurt (DAX)	3945.1	-1.5	-0.5
Tokyo (NIKKEI 225)	11,580.6	-0.5	8.5
Hong Kong (Hang Seng)	11,849.8	-2.6	-5.8
Toronto (S&P/TSX Composite)	8575.4	1.8	4.3
Mexico City (IPC)	10,137.9	-0.1	15.3

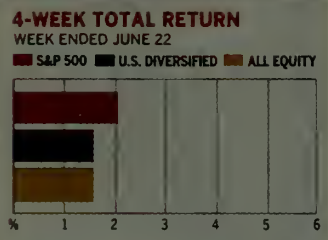
FUNDAMENTALS	JUNE 22	WEEK AGO
S&P 500 Dividend Yield	1.63%	1.64%
S&P 500 P/E Ratio (Trailing 12 mos.)	21.1	21.2
S&P 500 P/E Ratio (Next 12 mos.)*	16.9	16.4
First Call Earnings Revision*	1.22%	1.83%

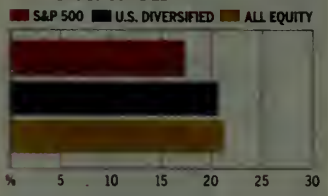
TECHNICAL INDICATORS	JUNE 22	WEEK AGO
S&P 500 200-day average	1094.9	1092.0
Stocks above 200-day average	64.0%	62.0%
Options: Put/call ratio	0.74	0.81
Insiders: Vickers NYSE Sell/buy ratio	3.16	3.11

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Steel	23.0	Internet Software	115.0
Internet Software	19.0	Oil & Gas Refining	73.1
Constr. & Engineering	18.7	Internet Retail	72.8
Tires & Rubber	18.6	Wireless Services	71.9
Food Chains	13.9	Steel	71.0

WORST-PERFORMING GROUPS	LAST MONTH %	
Casinos	-6.7	Airlines
Advertising	-3.3	Broadcasting
Broadcasting	-2.9	Intgrd. Telecomms. Svc
Publishing & Printing	-1.7	Insurance Brokers
Hypermkts. & Suprcntrs.	-1.4	Photographic Products

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Japan	5.8	Japan	48.5
Real Estate	4.9	Small-cap Value	32.6
Natural Resources	4.1	Diversified Pacific/Asia	31.4
Latin America	3.2	Natural Resources	31.3
LAGGARDS		**LAGGARDS**	
Pacific/Asia ex-Japan	-3.5	Domestic Hybrid	10.4
Precious Metals	-1.7	Utilities	11.9
Diversified Emerg. Mkts.	-0.9	Large-cap Growth	14.8
Health	-0.6	Health	15.1

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Japan Smaller Companies	8.6	Fidelity Japan Small Co.	85.0
ProFds. Rl. Est. Usr. Inv.	7.7	Pacific Advs. Sm. Cap A	81.8
ProFunds Ult. Japan Inv.	7.7	ProFds. Wrlss. Ultsr. Inv.	74.4
T Rowe Price Japan	7.7	Matthews Japan	72.7
LAGGARDS		**LAGGARDS**	
Eaton Vance Grtr. India A	-7.9	ProFunds UltSh. OTC Inv.	-42.1
iShares MSCI Taiwan Idx.	-7.2	Rydex Dynam. Vent. 100	-41.9
Fidelity Southeast Asia	-6.9	Potomac Sm. Cap/Sh. Inv	-29.6
Frontier Equity	-6.9	Rydex Dynam. Vent. 100	-29.6

INTEREST RATES

KEY RATES	JUNE 23	WEEK AGO
Money Market Funds	[illegible]	[illegible]
90-Day Treasury Bills	1.28	1.30
2-Year Treasury Notes	2.73	[illegible]
10-Year Treasury Notes	4.70	4.72
30-Year Treasury Bonds	5.38	[illegible]
30-Year Fixed Mortgage †	6.22	6.30

†BanxQu

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR
General Obligations	[illegible]	
Taxable Equivalent	5.83	
Insured Revenue Bonds	4.23	
Taxable Equivalent	6.04	

THE WEEK AHEAD

PERSONAL INCOME *Monday, June 28, 8:30 a.m. EDT* » Personal income in May probably grew by 0.5%, following a 0.6% jump in April. That's based on the median forecast of economists surveyed by Action Economics. Consumer expenditures most likely rose by 0.7% on strong auto sales, after a 0.3% gain in April.

FOMC MEETING *Tuesday, June 29, 9 a.m. EDT* » The Federal Reserve Board's Open Market Committee will meet for two days to set monetary policy. Economists surveyed by Action Economics unanimously expect the Fed will raise rates. The consensus view is a quarter percentage point hike in the fed funds rate, to 1.25%.

PURCHASING MANAGERS' INDEX *Thursday, July 1, 10 a.m. EDT* » The Institute for Supply Management's June industrial activity index most likely cooled to 61.8%, from 62.8% for May.

EMPLOYMENT *Friday, July 2, 8:30 a.m. EDT* » Nonfarm payrolls probably expanded by 243,000 in June, after a gain of 248,000 in May. Factory payrolls are forecast to have grown by 29,000. The jobless rate most likely remained steady at 5.6%.

FACTORY INVENTORIES *Friday, July 2, 10 a.m. EDT* » Manufacturing inventories most likely increased 0.4% in May, following a 0.3% rise in April.

The *BusinessWeek* production fell to 218.6 for the week ended 12, but still rose 12.2% from a ago. Before calculation of the week moving average, the slipped to 216.9.

BusinessWeek onl

For the BW50, more investm data, and the components of the production index visit www.businessweek.com/magazine/ex

he Companies

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High Stakes for Alan Greenspan

FEDERAL RESERVE CHAIRMAN Alan Greenspan is playing his last hand. He is about to start raising interest rates for the first time in four years, and the economic prosperity of America—and the world—depends on Greenspan getting it right. Despite his confident public stance, he is sure to realize that the path ahead is strewn with uncertainties, some of which the U.S. has never faced before. A misstep in tightening monetary policy now could have not only economic consequences but also political ramifications for the November Presidential election. Greenspan's own legacy as one of the great central bankers of all time may be at stake.

His immediate task ahead appears simple: wean the economy off its dependence on very cheap money without undermining the recovery or allowing inflation to take off. He'll probably start off at the Fed's June 29-30 meeting with a small 25 basis-point hike in the short-term federal funds rate, to 1¼%, and follow with a series of modest hikes through 2004 and perhaps into next year. But how fast Greenspan should proceed is open to question (page 36).

Consider inflation. One of the great surprises of the current recovery is the surge in commodity prices, especially oil, thanks to China's growth and soaring demand for imports. Another surprise is the unexpectedly quick return of corporate pricing power. Government statistics may show that core inflation remains low, but people are paying more for milk, napkins, health care, houses, movies, and, of c gas. The sudden wave of higher prices may ebb, but ma not. If it continues, higher prices could lead to inflation expectations, giving Greenspan reason to speed up the

Nothing exemplifies the uncertainties Greenspan face better than June 30, the second day the Fed meets. It's th day the U.S. hands sovereign to the Iraqis and a reminder t the Middle East—and al Qae remain treacherous geopoliti imponderables that could sho financial markets and hurt gr

As he raises rates, the Fed chief's path is strewn with uncertainty

If the past is any prologue Greenspan's behavior, the '9 show he would rather go slo in tightening monetary polic reason is simple: productivit Productivity is the key variab determining the economy's s and Greenspan correctly fore that higher productivity allowed faster noninflationary growth. Record low unemployment and higher real wag resulted, but so did the tech boom and stock market bub

Productivity is growing today even faster than in the averaging an astonishing 4.5% annually since the begin of 2001. But Greenspan doesn't know how long this can sustained or how far it may fall. There also appears to b plenty of slack capacity left over from the bust, but, agai Greenspan doesn't know how much of it is obsolete. Ev more worrisome, surging home prices, up 7.5% over the year, may be a warning that a bubble in housing prices i developing. In the '90s, Greenspan made a decision not preventing a bubble but to manage problems resulting f bursting. He may face that choice again.

Greenspan's term is up in 2006, after serving since 19 chairman. He'll need all his experience to guide America the world, through the unpredictable times ahead.

California: Still Too Costly for Business

REPUBLICAN GOVERNOR Arnold Schwarzenegger is doing a notably good job. Confounding his critics, he has pushed through ballot initiatives to borrow $15 billion to finance California's huge budget deficits. More important, he has persuaded a Democratic-led legislature to cut the state's soaring workers' compensation costs by overhauling medical coverage. Short-term, California no longer faces a financial crisis. But the ex-actor will have to use more of his charm in Sacramento if California is going t improve its business climate and stop companies from leaving for such states as Texas, Arizona, or Oregon (pag

California is still paying a steep price for a botched efl deregulating electricity that left it open to massive price manipulation by Enron and others. Brownouts threaten state this summer, while electricity rates appear to be too for many businesses but too low to stimulate constructio more generating capacity. Texas doesn't have this proble California has to find a way to solve it, too.

California is also putting new financial and regulatory burdens on companies just as they struggle to gain footi the recovery. Mandating "family leave" for all workers, including fathers, may be a social good, but the timing is It is one more pressure on businesses to move out of the

Schwarzenegger is proving that a tough guy can imp a modicum of civility on battling partisan politicians to the problems at hand. Now the legislature must meet hi more than halfway to ensure California's long-term economic future.

ness Week
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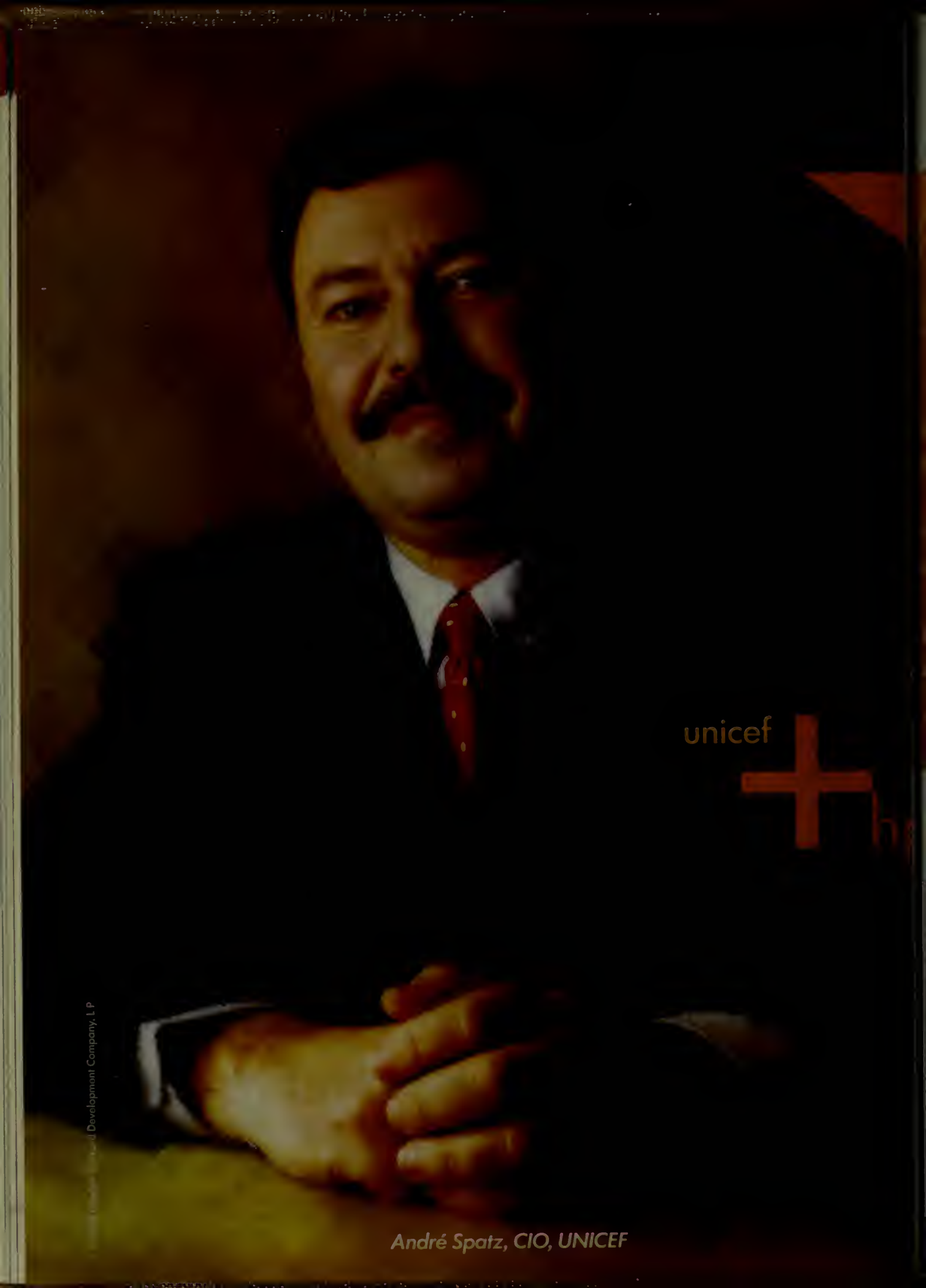

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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Technology Special Report: High-Tech Marketing

The world's 1.3 billion cell phones offer marketers a potential direct link to consumers, and they're starting to exploit it. Plus: Software to personalize a pitch, and advertisers go after gamers

China Airs Some Very Dirty Laundry

A recent government report uncovered billions of dollars lost to mismanagement and fraud in China's state-owned enterprises. While the massive corruption doesn't come as a surprise, Beijing's willingness to expose it does

Microsoft-SAP: Following The E-mail Trail

At the Oracle antitrust trial, new documents and testimony show just how threatened Bill Gates & Co. felt by Larry Ellison's hostile takeover bid for software rival PeopleSoft

America, Get Ready for "Ringbacks"

First came the customizable ringtones your cell phone plays wh it gets a call. Next could be personalized tunes your callers hear before you pick up. Already popular in Asia, U.S. providers searching for new revenue opportunities are gearing up

Yes, Wall Street Research Really Is Better

Despite the cost—and the closed-door complaining—stock analysis has clearly improved after the Spitzer settlement's forced changes

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UP Front

"It's like having a rather large weight lifted off my shoulders."

–L. Paul Bremer on handing over power to Iraq's new prime minister, on ABC's Good Morning America

TED BY IRA SAGER

ROFIT & GLOSS

HAT COULD RUNCH APPLE HARES

ESE ARE heady days for ple shareholders. Stoked part by the success of the d music player, Apple ares have surged to nearly 4 recently—the highest in ar years. The nup would em to validate ecent wave bullish alyst reports. t Apple's rnings per are could fall amatically if forced to pense stock options der new Financial counting Standards Board ASB) rules.

The accounting change o could expose another eakness: In the last four arters, Apple earned $32 llion after taxes from inter- t on its $4.6 billion cash rde. That's nearly twice as uch as the $18.5 million in operating income it would have earned under the pending FASB rules, says Albert Meyer, principal of **2nd Opinion Research.** "Is it a tech company or a credit union?" Meyer asks.

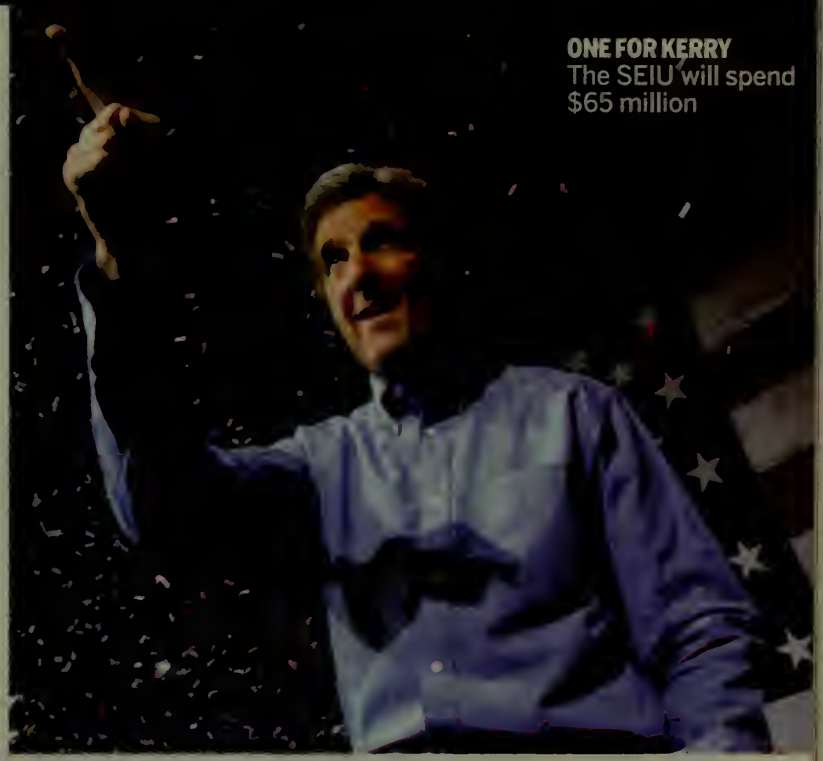
If stock options had been treated as a cost, Apple's $179 million in earnings over the last four quarters ended on Mar. 27 would have fallen 69%—significantly more than the potential drops of under 50% for other tech companies such as **Dell.** Out of 86 tech companies, Apple was among the 12 with the biggest hit to estimated 2005 earnings, according to **Merrill Lynch.**

To match its interest profits, Apple would need to double earnings from operations in the next 12 months. That could be hard when Apple says margins on its iPods will drop in the coming year. Apple declined to comment. *–Alex Salkever*

HE BIG PICTURE

HY BOTHER For most companies, edging energy costs isn't worth e expense and trouble.

June survey of 356 CFOs by Financial Executives International Baruch College's Zicklin School of Business



ONE FOR KERRY The SEIU will spend $65 million

CAMPAIGN 2004

Really Laboring To Beat Bush

THE NATION'S LARGEST union will shell out $65 million to campaign against the reelection of President George Bush. On June 23, the 1.6 million-member **Service Employees International Union** (SEIU) announced at its annual convention that $40 million will go to pay for 2,000 union members to work full-time as political organizers until November. Thousands of union members volunteer in every national political election—the SEIU expects 50,000 members will do so by the fall—but most do it nights and weekends and only take off a few days or a week right before the vote.

The rest of the money will go to more traditional activities, such as registering members to vote and educating them about campaign issues. The union's anti-Bush war chest is a huge sum, given that the **AFL-CIO** will spend only $44 million. SEIU President Andy Stern's ambitious plan will give a big boost to likely Democratic nominee John Kerry, whom the union endorsed—but only after first supporting former Vermont Governor Howard Dean. "We're going to build the strongest grassroots political voice in North America," Stern told his members. Well, if money talks... *–Aaron Bernstein*

UP Front

INCONGRUOUS

WE THE PEOPLE ...CAN'T MAKE COPIES?

HOW MUCH is the U.S. Constitution worth to you? On **Amazon.com**, the going rate is $2.99. A copy of the founding document, long in the public domain, can be acquired easily and legally for free on the Internet or at any public library. But e-book publisher **NuVision Publications** has begun selling it online as an e-book in an encrypted format that can be printed only twice per year. "I'm speechless, frankly," says **U.S. National Archives & Records Administration** spokesperson Susan Cooper. "[But] that's the beauty of the Constitution—it allows people to do things like that." NuVision did not respond for comment.

Oddly enough, people seem to be buying the Constitution. The e-book's Amazon sales ranking, as of June 29, was a respectable 1,016 out of the hundreds of thousands of books Amazon sells on its Web site. That's despite the fact that helping someone print the e-book more than twice could violate the Digital Millennium Copyright Act, the 1998 law that forbids tampering with anti-piracy protections, according to Wendy Seltzer, a staff attorney with the **Electronic Frontier Foundation.**

The irony of encrypting the Constitution isn't completely lost on customers. "Imagine if the original had such restrictions; it would have taken only seven years to send a copy to all 13 colonies," reads one review on Amazon—where the Constitution has chalked up an average rating of just one star out of five. *–Seth Porges*

TOOTH IN ADVERTISING

TOSS THE FLOSS The mouthwash marketer and Pfizer have a new claim they can make in their battle against plaque. The American Dental Assn. has given its blessing to market Listerine as a replacement for flossing: Just rinse twice a day. The 120-year-old mouthwash—originally available only by prescription—towers over rivals, with 51% of the $1 billion market. But those customers may not be gargling. Some view Listerine as an all-purpose product. Fans say it can prevent lice, eradicate dandruff, clean dogs' ears, disinfect blisters, ease pain from shingles, and do away with those nasty fungus infections between your toes. Pfizer, of course, promotes it as labeled. *–Jessi Hempel*

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FACE TIME

TOM JOYNER

P&G'S FAVORITE DEEJAY

Tom "Fly Jock" Joyner may not be a household name in the marketing suites of Corporate America. But a deal inked on June 14 with consumer-products giant Procter & Gamble could change that. Joyner, who hosts the *Tom Joyner Morning Show*, is the nation's most widely syndicated African American deejay.

P&G wants to bolster its appeal to Joyner's 8 million listeners. The multimillion-dollar pact goes way beyond the usual radio ads, including sponsorship of minority health promotions and fund-raising for black colleges. The deal also calls for the nation's largest advertiser to study the effectiveness of urban radio, which could change the perceptions of other marketers. "Hopefully this will open doors for everybody," says the Fly Jock, who earned his moniker when he used to fly between Dallas and Chicago to do daily shows.

If Joyner can boost sales for P&G, it won't be long before other marketers start tuning in to the Fly Jock.

–Stephanie Anderson Forest

SLUGFESTS

BURNING TO BURN INSTANT CDs

THERE'S A BATTLE brewing in concert halls across the U.S. **Clear Channel Communications'** Instant Live unit records concerts and burns CDs for sale right after a show. But rivals in that nascent business fret that Clear Channel, which owns a substantial number of concert venues, will block the use of their services.

In a Mar. 31 e-mail obtained by *BusinessWeek*, Clear Channel Executive Vice-President Steven Simon wrote to Sami Valkonen, president of rival **DiscLive:** "DiscLive will not be permitted in our venues or at our shows." Valkonen confirmed the e-mail but declined comment. Another rival, Brady Lahr, president of **Kufala Recordings,** says his service was blocked at a July, 2003, show at a Los Angeles Clear Channel venue.

In an interview with *BusinessWeek*, Simon said that artists could choose any service. A Clear Channel spokesperson says the e-mail was sent because DiscLive did not make prior arrangements, and that it allows third parties at its venues. As for the Kufala allegation, "nobody knows what they're talking about."

Another concern: Clear Channel recently acquired a patent for Instant Live's technology. DiscLive and others argue that the patent ignores prior technology. On June 30, the **Electronic Frontier Foundation** said it will petition t revoke the patent as part o effort to fight patents it believes are overly broad.

The instant-CD market showing signs of life. Arou 20% of concertgoers buy t $20 to $30 disks for acts s as Kiss and Jewel. And Cle Channel has a deal to sell disks at music chains **FYE, Virgin,** and **Tower Records.** I the moribund music biz, t a revenue stream worth fighting for. *–Brian Hindo*

WEB WATCH

CHINA'S GREAT MARCH ONLINE

THE WEB SEARCH WARS raging in the U.S. are spilling over to the Middle Kingdom. On June 21, **Yahoo!** rolled out a Chinese-language service called **Yisou.** Six days earlier, rival **Google** and a group of investors said they bought a stake in **Baidu,** a top Chinese search engine. Analysts expect other U.S. players, including **Amazon.com, Microsoft,** and **America Online** to follow.

No wonder: With backing from Beijing and an economy that's putting more PCs in homes, China has 80 million Net users, second only to the U.S. And it's adding more than any other country. If forecasts by investment bank **Piper Jaffray** hold, 153 million Chinese will be online by 2006—passing the U.S. At that rate, U.S. companies can't dawdle too long before diving into the Chinese market. *–Heather Green*

THE STAT

42

The approximate number of the 750 active Major League Baseball players with college degrees –including three from Japan.

Data: San Francisco Chronicle

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CELEBRATING 75

As part of its anniversary celebration, BusinessWeek *is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. In late September, 2004,* BusinessWeek *will publish a special commemorative issue on Innovation.*

Putting Words To the Dream

IT WAS JANUARY, 1956, and a crowd of angry black men, women, and children milled outside Martin Luther King Jr.'s smoldering house in Montgomery, Ala. Many brandished broken soda bottles, .38-caliber guns, or knives, hungry for revenge after white extremists had hurled homemade bombs through a window, endangering King's wife and 10-week-old baby. The humiliation of back-of-the-bus oppression and a nation's searing hostility had pushed them to the doorstep of violence. King faced the fiery throng, shaken but calm, and urged restraint. "I want you to love your enemies," he told them, persuading the crowd to reject violence that night. "We must meet hate with love."

Like no other leader, King was able to give America's conscience a voice. He demanded a better nation—one committed to breaking the back of racism without shedding blood. Of course, King did not invent nonviolent protest. He studied Gandhi's methods and borrowed from the teachings of Jesus. But during the incendiary '50s and '60s, King's genius was to adapt the lessons of civil disobedience to America's core values of justice and fairness. His eloquence, combined with an irresistible sense of righteousness, helped harness a people's fury and turn it into action. "The miracle of Martin Luther King was that he not only understood the morality of nonviolent social change but also made it work," says Andrew J. Young Jr., former Atlanta mayor, diplomat, and a King confidante.

King was a patriot, too. The black freedom struggle, he argued using references to the Declaration of Independence and the Constitution, was nothing less than a way to an improved democratic republic. Such values touched white America: It became hard to disagree with his message. He was, says biographer Taylor Branch, "a modern founding father."

King stressed black earning power, never losing sight of the economic underpinnings of his cause

A third-generation Baptist minister, King was born into a comfortable Atlanta home i 1929. He showed a sharp intelligence and entered Morehouse College without finishir high school. Before earning a doctorate in theology in 1955 he became the 20th pastor Montgomery's historic Dexter Avenue Bapt Church. It was there that King's words bega shape how the nation grasped its racial cris

King never lost sight of the economic underpinnings of his cause. Gandhi's "salt march" to the sea in 1930 to protest the Briti monopoly of salt production in India served King's inspiration for the 1963 March on Washington. The preacher adapted nonviole protest to include various forms of economic withdrawal. B refusing to ride buses and purchase cars and groceries fron retailers hostile to blacks, King forced businesses to recogni black purchasing power. Until then, they felt they could dis-regard black consumers and still thrive. King stressed black earning power. His boycotts taught companies that discrim ination equals slimmer profits. "We don't need any bricks a bottles....We just need to go around to these stores and say.. God sent us by here to say that you're not treating His child right," King preached the night before he was assassinated 1968. By then, Wall Street was hiring its first black bankers, President Lyndon B. Johnson had signed the Civil Rights A The changes Martin Luther King helped set in motion rippl through America today—still a work in progress. ■

–By Roger O. Croc

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Honored To Be Honored

The judges of the Gerald Loeb Awards for Distinguished Business & Financial Journalism have honored a pair of *BusinessWeek* stories that examined white-collar offshoring. "Is your job next?" (Feb. 3, 2003) by Pete Engardio, Aaron Bernstein, and Manjeet Kripalani spotted the trend early, and "The rise of India" (Dec. 8) by Kripalani and Engardio explored how India's world-class engineering graduates are becoming enmeshed in America's New Economy. These two stories won in the Loeb's magazine category. Also, "Boeing: What really happened" (Dec. 15) by Stanley Holmes was a finalist in the deadline-writing category. We are honored, and we thank the G. & R. Loeb Foundation and UCLA's John E. Anderson Graduate School of Management, administrators of the award.

REAGAN STILL INSPIRES HEATED DEBATE

YOUR EXCELLENT ARTICLE "Reagan's economic legacy" (News: Analysis & Commentary, June 21) made me wonder whether 1981 was the beginning of a once-in-a-lifetime event where the overhaul in the tax system, coupled with the start of the Information Revolution and soon-to-be start of a multiyear decline in interest rates, set the stage for the biggest boom in financial markets that may ever occur. While you are accurate in identifying the multiple impacts of Reagan's legacy, I believe a seminal impact was that it spurred renewed investor interest in the financial markets. After the horrible returns of the inflationary '70s, investor interest in the stock market hit an extraordinary low. Reagan's policies were a critical ingredient in the 18-year bull run that has resulted in record levels of stock ownership and, more important, record interest in the stock market by the public.

–Robert Parish
Jupiter, Fla.

RESTRICTIONS ON FREE-MARKET activities such as a higher minimum wage and increased unionization benefit particular constituencies at the expense of everyone else and have led to stagnant labor conditions in Germany and France. If our politicians could stand up to all special interests (labor unions, attorneys, and other entities seeking special treatment), we could improve our educational system and provide employees who are worth more to employers—and can command reasonable compensation in a free labor market.

–Dave Berry
Kennesaw, Ga.

"REAGANOMICS vs. Rubinomics" comes out a draw only if you're completely ambivalent about rising debt levels (News: Analysis & Commentary, June 21). But no reasonable person is. Would it make a difference if our national debt were suddenly forgiven in full? You bet it would! Deficits are a very blunt instrument to stimulate growth. That's why anybody can grow an economy, or a company for that matter, by piling up debt.

It takes extraordinary skill to grow an economy while simultaneously reducing debt and thereby improving confidence in our fiscal management. That both p sector job growth and gross don product growth during the Rubin exceeded those of the Reagan ye quite remarkable in light of the deficits can play to stimulate gr Rubinomics wins hands down.

–Jim S
North Andover,

YOU FORGOT TO SAY that six montl fore Clinton took office, gross na product was up five out of six month that when he left office it was dow out of six months. Not a good recor

–Clarenc
Wilmington

CORRECTIONS & CLARIFICATIONS

"Roll them bones" (In Biz This Week, June 28) should have said that Kirk Kerkorian was paid an extraordinary $1.4 billion dividend by Metro-Goldwyn-Mayer studio, not MGM Mirage casino.

In "Winners 2004: The best product designs of the year" (Annual Design Awards, July 5), the introductory text to the lifestyle products should have referred to Korea's Samsung, not Japan's Matsushita Electric, as designer of microwave ovens that will hold American-size pizzas.

"How Clinton could help—and hurt—Kerry" (Washington Outlook, June 28) referred to former President Bill Clinton's memoir as *My Story*. The correct title is *My Life*.

The map accompanying "How safe?" (News: Analysis & Commentary, June 28) should have shown Athens near the Saronic Gulf, not the Ionian Sea.

"Let's all play golf—just not here" (Sports Biz, June 21) described Pine Valley's golf course as off-limits to female players. In fact, women guests are permitted to play, but only on Sunday afternoons.

NEXTEL: CELLULAR HAS PLENTY MORE ROOM TO GROW

RE "FINALLY, SERIOUS cell-phone bilities and services are rolling ("Wireless," The Info Tech 100, June Nextel Communications Inc. disa with In-Stat/MDR's assertion that th lular voice-communications mark slowing to 1% revenue growth in Nextel continues to experience impre and significant growth through the of its wireless voice and data service fact, in the first quarter of this year, N delivered a 31% increase in revenue the year before—and aggregate se revenues for the six major U.S. wir carriers were up over 13% when pared with the same period in 2003. ditionally, Nextel raised its guidance expects to add 1.9 million or more customers this year.

Our bullish outlook is shared by eral leading investment firms that s bright future for the entire wireless dustry as well. Nextel recognizes the portant growth potential that enhar data services bring to our industry its long-term success, but the fact mains that voice services are likel remain the driver of wireless indu revenues for the foreseeable future.

–Tom F
Chief Operating Of
Nextel Communications
Reston,

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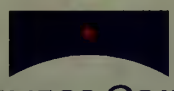

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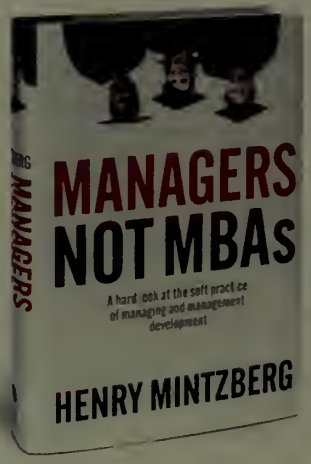
Masters of Barely Anything?

MANAGERS NOT MBAs A Hard Look at the Soft Practice of Managing and Management Development
By Henry Mintzberg; Berrett Koehler; 464pp; $27.95

The Masters of Business Administration is one of higher education's most respected degrees, both a touchstone of managerial ability and a ticket to the higher reaches of Corporate America. Now, though, comes an apostate—a respected professor of management studies who challenges the very basics of business education. In the scathing *Managers Not MBAs: A Hard Look at the Soft Practice of Managing and Management Development*, McGill University business professor Henry Mintzberg says today's B-school is essentially a sham.

In this provocative but often repetitive work, Mintzberg posits that MBA programs not only educate "the wrong people"—namely, those lacking sufficient experience—they actually fail to teach management. Rather than producing good administrators, B-schools foster an arrogant, "elitist" class who understand little yet think they can solve any problem. Mintzberg suggests replacing what he sees as broad and superficial MBA training with specialized programs, granting degrees such as a Masters of Business in Finance, or Retail, or Consulting. He also advocates revamping the current Executive MBA programs that offer midcareer, weekend schooling for those with full-time jobs. As a substitute, he favors attendance by teams from the same company, with study focusing on issues the execs are actually grappling with at work rather than on unrelated cases on wide-ranging topics.



Mintzberg makes some fair points—his charges of elitism seem particularly well-taken. But his book suffers from some misconceptions, and its prescriptions for change could create new ills. What's more, the author exaggerates, suggesting that MBA schooling is responsible for everything from unlawful corporate shenanigans to the corruption of society.

Management education should be for those who already have some background directing personnel, says Mintzberg, and most MBA students do not. "Trying to teach management to someone who has never managed is like trying to teach psychology to someone who has never met another human being," he argues. This lack of experience among students is a basic premise of the book—and it's overstated. According to B-schools and *BusinessWeek*'s own findings, most students at the top 50 U.S. programs have four to six years of work experience, often including at least a year or two of project management, team-leading, or service in a position with the title "manager." And though Mintzberg asserts that he has never met an Executive M student who is actually in a senior position, *BusinessWe* surveys show that students in these programs often hav such titles as vice-president, regional director, and chie operating officer.

Mintzberg sees a big problem in how B-schools prom "heroic management"—the notion that a CEO savior car come in from outside and fix anything. His favorite targe Harvard Business School, whose case studies, employed the near-exclusion of other approaches, provide narrow snapshots of the kinds of problems usually faced only by executives. That methodology, he persuasively argues, le MBA students to think of themselves as "superstars," ca of high-level decision-making. Instead, the author sugge Harvard produces more high-profile failures than you'd t In *Inside the Harvard Business School* (1990), former prof David W. Ewing listed 19 alums who had excelled, among them former Bendix CEO William Agee and former Continental Airlin CEO Frank Lorenzo. But as of 2003, Mintzb says, 10 of those had left their jobs on bad t Some were forced out, while others steered companies into bankruptcy through bad decisions. Only five ended up with good rec

Mintzberg believes business schools sho produce not heroic managers but "engagin managers." These are leaders who assist th under them, seek input from everyone whe forming strategy, and reward everyone whe organization succeeds. But Mintzberg's recommendations are flawed. For example, company-team approach suggests for executive education—one that he h used at McGill—may lead kind of tunnel vision. It's model that offers limited opportunity for interming of execs from various industries and only restric study of other fields.

B-schools' worst failing, says the author: Promoting the idea of the CEO as savior

Finally, Mintzberg overplays his critique by making management education the scapegoat for all that ails corporations—an much that afflicts society. After railing against the "corruption of established institutions," the author obser that "greed has been raised to some sort of higher calling and that "MBA education plays a significant role in this." That's a heavy load to lay on educational programs—especially since, as Mintzberg acknowledges, most CEOs a other top executives don't even have MBAs. ■

–By Jennifer M

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BY STEPHEN H. WILDSTROM

Why I'm Staying Away From Internet Explorer

In late June network security experts saw one of their worst fears realized. Attackers exploited a pair of known but unpatched flaws in Microsoft's Web server and Internet Explorer browser to compromise seemingly safe Web sites. People who browsed the sites using Windows computers—without downloading anything—were infected with malicious code. I've been increasingly concerned about IE's endless security problems, and this episode has convinced me that the program is simply too dangerous for routine use.

Fortunately, you are not stuck with IE as your default browser. For several weeks I have been testing three alternatives: Mozilla 1.7 and Firefox, both free from Mozilla.org, and Opera 7.5 from Norway's Opera Software, which costs $39 if you want an ad-free version. All include useful features, such as pop-up blockers, that are lacking in the current version of IE. Mozilla is based on code written by Netscape Communications, but I would avoid its poorly maintained cousin, Netscape 7.1. Firefox, officially still a test version, is a clean design and fast, while Opera offers tons of features. But the chief virtue of these browsers is that the they don't share IE's vulnerabilities.

Changing your default browser is simple. Most browsers will ask, when you open them the first time, if you want them to be the default. And if you're running the latest version of Windows XP, Service Pack 1, there's an application on the Start menu called Set Program Access and Defaults that makes switching painless.

FOR ALL OF ITS PROBLEMS, Internet Explorer isn't easy to give up. Some handy add-ons, such as the Google Toolbar, work only with IE. The Windows Update service requires it, and many corporations have developed custom IE-based applications. The travel-and-entertainment reporting system used by *BusinessWeek*, for example, works only with the Microsoft browser. So even if you default to another browser, you may still need IE from time to time.

Because IE will remain an inescapable fact of life, I hope Microsoft succeeds in its current effort to come up with a secure version. Later this summer the company will release Windows XP Service Pack 2, a major overhaul of Windows that focuses almost entirely on improving security. One component of SP2, as it is known, is a reworked browser that may make a big difference—but it will be many months before we know for sure.

The biggest security problem in IE—one t has plagued Microsoft and its customers for least four years and is at the heart of the rece exploit—is a flaw that lets a Web site trick th browser into running an alien program in violation of its own security settings. In effec an unknown program on a Web site is treate as though it were a trusted program on your computer. Compromised Web sites can cover install programs ranging from nuisances tha cause ad pop-ups to real threats that record your keystrokes to steal passwords and accou information.

Instead of making one more attempt to pl the hole, SP2 drastically restricts IE's ability t run any program without the explicit permission of the user. So even if the hole is s there, says Windows product manager Greg Sullivan, takin advantage of it "will be like breaking into jail." The hostil application would be blocked from doing any harm. This shouldn't cause problems during most browser use, but some custom corporate applications may fail. Other features of the new IE include changes that make it tougher for scammers to make phony bank Web sites look authentic There will also a long-overdue pop-up blocker.

The browser's endless security woes make it dangerous to use

In theory, the approach Microsoft is taking should solve t security problem. But we won't really know until the bad gu have a chance to bang on SP2 for a while. For the time being wherever possible, I'm staying away from IE. ■

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BY GARY S. BECKER

A 19-Year Dialogue on The Power of Incentive

When I was first asked to write Economic Viewpoint columns in 1985, I expected to do this for a year or two. I did not want to take too much time away from my research agenda. But I discovered that I immensely enjoye the opportunity to use economic reasoning to discuss important issues of the day in simple and nontechnical language. The years have gone by, an I have been doing this about once a month for 19 years. That is long enough, so this will be my last regular Viewpoint.

I BEGAN WRITING THESE COLUMNS soon after the reelection of President Ronald Reagan. Most economists in those days who discussed economic issues in the media concentrated on forecasting movements in gross domestic product and inflation and other macroeconomic questions. These are important, but there was a vacuum in discussions of public policies and events that affected the incentives of individuals, families, companies, and governments. Since I have spent my career teaching and researching how incentives affect behavior, it seemed natural for me to help fill this vacuum.

Friends had told me that the first few columns would be easy, but warned that after a while I would run out of ideas and topics. Actually, the reverse has been true: The first few columns were among the most difficult. It is hard to express complicated economic thinking in simple language that can be understood by the intelligent non-economist. The struggle to do that was made much easier by my wife's help and by her earlier experience in journalism.

Finding topics has usually been easy, because events continue to serve up new economic issues, or old issues in new clothing, that push and pull incentives in different directions. For example, the end of the Cold War and the retreat of communism was not only the defining event of the second half of the 20th century, but it also brought an opportunity to test whether all our preaching and analysis about the importance of incentives really make a large difference. The bumpy but successful transition of Russia, much of Eastern Europe, and especially China from socialist to market economies shows that giving individuals more responsibility does produce big economic gains.

I have been critical of the debilitating effects of onerous regulations in investment, employment, and prices. These criticisms were confirmed by events in India after the reforms started in 1991 by the excellent economist, Manmohan Singh, recently named Prime Minister. By reducing massive controls over private investment, tariffs, and other regulations, India went from a basket case that continually sought and received international aid to a dynamic economy with annual GDP growth rates above 6%. India has to do much more to sust its rapid economic growth, but what a nice turn of events! France, Germany, Italy, and other Western European natio could end their decade-long stagnation if they would learn the same fundamental lesson, freeing up their labor marke reducing taxes, and instituting other economic reforms.

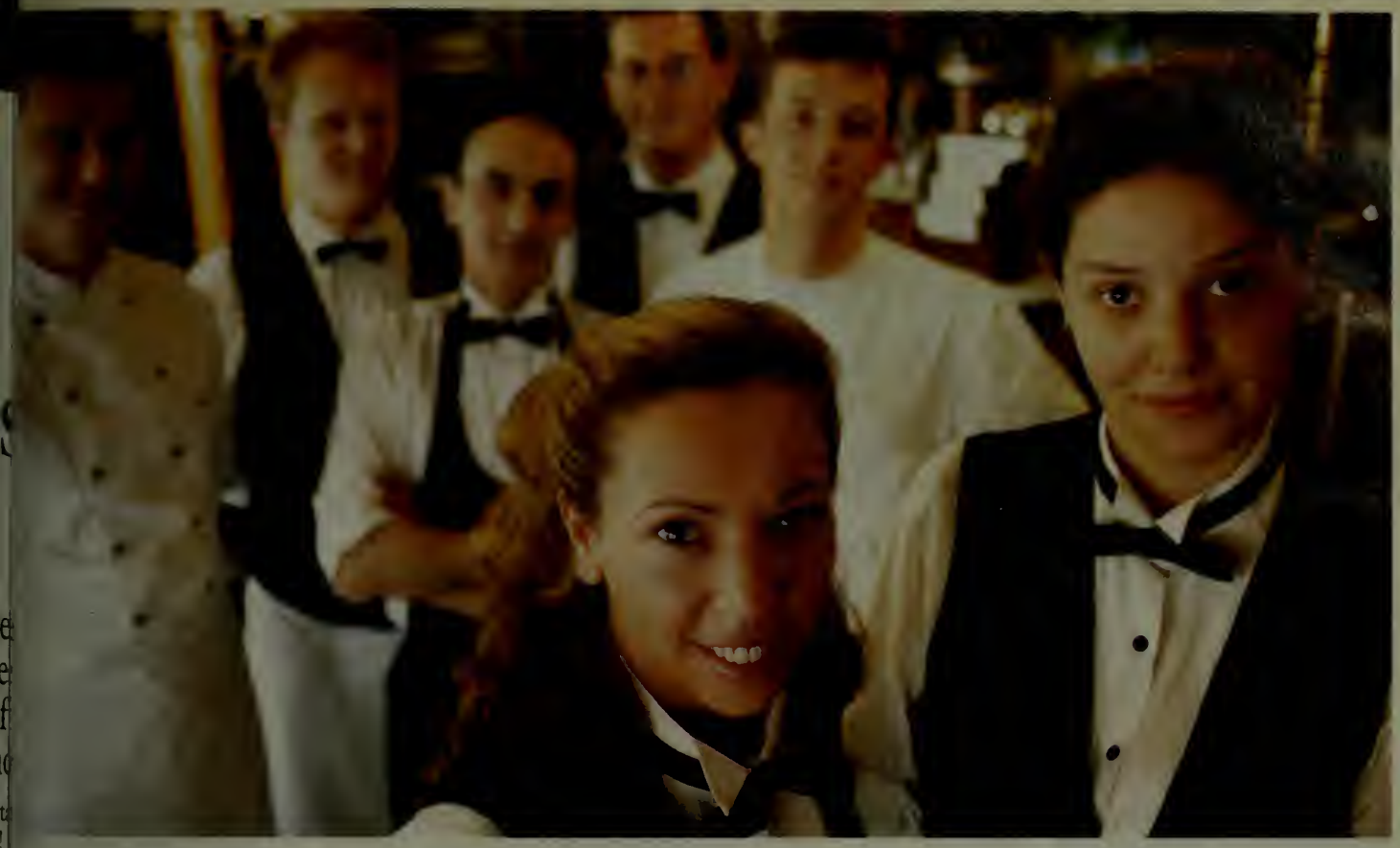
At home, the Personal Responsibility & Work Opportun Reconciliation Act of 1996 provided a chance to check predictions in prior columns about the negative effects of welfare on the incentive to work. The analysis passed with flying colors as welfare rolls melted under the work incenti provided by this law.

Along with many others of my generation, I was a social when I started my university studies. But my first few econom courses taught me the power of competition, markets, and incentives, and I quickly became classical liberal. That means someone who believes in the pov of individual responsibility, a market economy, and a crucial b limited role of government. I hav not hesitated to express these beliefs in evaluating policies of both Democratic and Republicar Administrations. I understand th politics often trumps economics, but it is a mistake to excus misguided policies because one generally sympathizes with particular party or person.

> Finding topics was easy: Events continue to serve up new issues

I have enjoyed many aspects of writing these columns, but the most rewarding surely has been the interaction wi readers through letters, e-mails, and personal contacts. Some readers have indicated that I opened their eyes to th deeper effects of different policies, while others have disagreed, occasionally in strong language. But I always fe there was an ongoing dialogue, and there is nothing more satisfying to a writer. ■

Gary S. Becker, *the 1992 Nobel laureate, teaches at the University of Chicago and is a Fellow of the Hoover Institution*



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JAMES C. COOPER & KATHLEEN MADIGAN

The Economy Slows—From a Gallop to a Canter

steadier pace, along with Fed rate hikes, should calm inflation fears

U.S. ECONOMY When the Federal Reserve did the expected on June) and raised interest rates, its aim was to start removing the cessive stimulus coursing through the economy. But changes in onetary policy take a while to work through the system. Recent ews reports suggest that demand may have been easing before the

l increased its target for the federal funds rate by a arter-point, from 1% to 1.25%. That slowing should ke the Fed's job easier.

In its accompanying statement, the Fed said the upside d downside risks to achieving sustainable economic wth and price stability are about equal. Policymakers o noted, even after the rate hike, that monetary policy mains accommodative," and they repeated their goal remove that stimulus at a "measured" pace. However, Fed left the door open for more rapid hikes if needed fulfill its obligation to maintain price stability."

The Fed's assessment of the economy and its hints out future policy moves echoed sentiments mentioned er the May 4 meeting. This consistency reassured the ancial markets. The "measured" language is widely wed as a signal that the Fed will continue with quarter-int hikes, probably at each meeting, until the funds rate ches a level that neither helps nor harms growth.

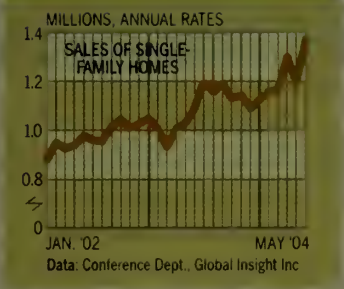
Don't expect the economy to react immediately to the ne hike. True, in today's just-in-time environment, ancial markets adjust more quickly than they once did Fed action. But policy moves work best when a few of em have accumulated in the system. So even if the Fed mps up rates at every meeting, the effects won't be ly felt until much later this year.

For now, the economy seems to be responding to the ancial and policy conditions in place before June 30. nsider the spring increase in long-term rates. Part of e rise was caused by the expectation of Fed action, but was also a response to surprise jumps in the inflation mbers. Rising yields caused consumers to buy homes a record pace in May (chart). That surge added to cond-quarter growth—but probably stole sales from the ird and fourth quarters. Higher mortgage rates also cut to refinancings, which had been a big source of funds r consumer spending. In addition, the boost from last ar's tax cuts is waning.

ON'T CONFUSE moderate growth for meek, though. owth in real gross domestic product is probably wing to an annual rate of below 4% in the second half, wn from a gallop of 4.8% over the year ended in the st quarter. The projected pace will still be fast enough to generate new jobs, profits, and incomes. And depending on future inventory growth, real GDP has the potential to beat expectations.

More important for future interest rates, the easing in growth means inflation won't have a chance to gain much traction. So the Fed can proceed at its preferred gradual pace. That means there is less potential for disruption in the financial markets or in the economy.

HOME SALES SOAR TO NEW RECORD HIGH



Data: Conference Dept., Global Insight Inc

A key factor in the second half, given the loss of fiscal stimulus and rising energy prices, will be consumer spending. It slowed last quarter, in part because consumers were paying more for gasoline. Real consumer purchases in May rose 0.4%, after no gain in April. So far in the second quarter, real spending is growing at an annual rate of 1.9%, half the 3.8% advance in the first quarter.

HOWEVER, CONSUMER ATTITUDES and income gains suggest that demand will rebound this summer. Real aftertax income has increased at a 2.6% annual rate so far in the second quarter, on top of a 4.9% gain in the first. Since income is rising faster than spending, consumers are building a cushion that can finance future purchases.

That extra income—along with expectations for bigger paychecks ahead—is contributing to renewed economic optimism. The Conference Board's consumer confidence index rose nearly nine points in June. At 101.9, the index is the highest in two years (chart, page 30).

Consumers are particularly upbeat about job prospects in the second half. A growing percentage of respondents also expect their incomes to be higher six months from now. Fatter paychecks will lift spending even as Fed rate hikes begin to slow the pace of household borrowing.

Besides consumers, look for two other sectors—imports and inventories—to play big roles in the economy's second-half performance while at the same time pos-

sibly aiding the Fed in its goal to keep a lid on inflation.

Inventories and imports, though often overlooked, were prominent in the latest report on first-quarter GDP. The Commerce Dept. made an unusually large change in real GDP growth. The economy grew at a 3.9% annual rate instead of the previous rate of 4.4%.

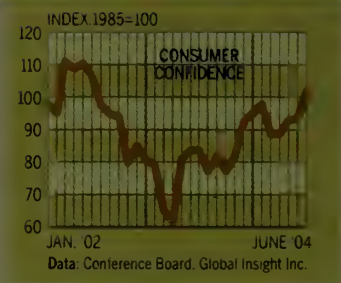
Commerce said imports rose at a 10.4% annual clip, faster than the 5.9% rate previously reported. That lowered economic growth, since imports are subtracted from the GDP calculation because they represent domestic demand satisfied by overseas output.

For the Fed, the increase in imports will make inflation-fighting easier. First, there is less danger that the U.S. economy can overheat when much of domestic demand can be satisfied by foreign production capacity. Second, global competition limits price increases here in the U.S., especially for goods producers.

THE CONTINUED RISE in imports was not unexpected. The more U.S. demand grows, the more the economy attracts imports. The latest inventory trends are a bit surprising, though. Economists had expected inventory rebuilding to significantly boost economic growth in the first half. But the GDP data plus monthly numbers suggest that companies are still having a hard time restocking their shelves.

Real nonfarm inventories grew by $25.5 billion in the first quarter, less than the $28.2 billion previously estimated. The monthly inventory data, which are not adjusted for price changes, show total business inventories rising just 0.5% in April, while May stockpiles of dura goods rose 0.4%, even though factory output soared i those two months. The inventory gains are on a par w the monthly rises averaged in the first quarter. That's a sign inventories last quarter accumulated at about the same pace as in the first, resulting in little additional growth in real GDP.

CONSUMER SPIRITS TURN MUCH BRIGHTER



Data: Conference Board, Global Insight Inc.

Yet that weakness could be an advantag the second half—and reverse some of the recent price jumps. I businesses finally get serious about buildin inventories, the incre in orders will push u industrial production sales. In fact, a conce effort to restock coul cause real GDP growt pop up to 5% for a quarter. Plus, higher inventory lev would lessen some of the delivery delays that have contributed to the buildup of cost pressures lately.

Easing nascent inflation fears will be important, si the relief offered would allow the Fed to move at its w communicated measured pace. Policymakers are awa that, like a ship on the open sea, the U.S. economy ca be turned on a dime. And the Fed wants plenty of tim pilot the economy on its intended course of steady growth and low inflation. ■

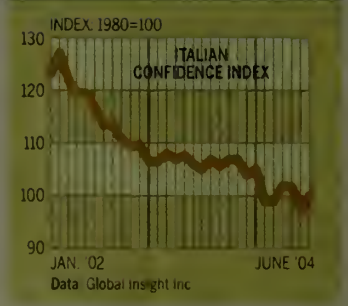
ITALY

Gloom Could Ruin Rome's Budget Plans

ITALY'S ECONOMY is recovering, but at a subdued rate, hobbled by rising oil prices and pessimism. The lagging pace of economic growth will greatly complicate Rome's budget plans.

Consumers and executives are growing more concerned about the economy's direction. The index of manufacturing confidence in June unexpectedly slid for the second month in a row. Rising inflation and excessive inventories are worrying executives. However, Italian exporters, at least, are benefiting from faster growth in the U.S. and Asia. Increasing shipments overseas are likely to lift Italy's real gross domestic product this year. Real GDP is expected to grow between 1.2% and 1.4% in 2004. Either pace would be better than the 0.4% growth of 2003, but it will lag the expected growth of about 1.8% for the entire euro zone.

CONFIDENCE IS NEAR A 10-YEAR LOW



Data: Global Insight Inc.

Although consumer confidence rose in June, the index hovers near a 10-year low, held down by oil-related inflation worries and weak labor markets, with the jobless rate at 8.8% in April. Household spending had begun to recover. In the first quarter, it rose 0.8% from the fourth quarter. But the annual inflation rate rose to 2.4% in June, the highest pace in six months, cutting into buying power.

A weak economy is compounding Italy's budget problems. For two years now, the government of Prime Minister Silvio Berlusconi had relied on one-time real estate sales and t amnesty programs to lift revenues. Now, Italy's auditors are urging th government to cut spending permanently to keep the deficit fro exceeding the European Union's li of 3% of GDP. Unless Berlusconi takes drastic action, the nation risk being rebuked by the EU's finance ministers for missing the target. There's also a chance its bond ratin will be downgraded.

Berlusconi has pledged to meet EU's target in 2005, by cutting spending and extending the amnes plans. But the moves aren't coming fast enough to please voters. Berlusconi's party lost key local elections in Milan in June.

Certainly, faster economic growt would boost tax revenues. But with both businesses and consumers so gloomy, domestic demand probabl won't pick up quickly enough to so Italy's fiscal problems. ■

Joachim Fels, Economist

The Euro: coming of age or coming apart?

It's about time that investors start considering what might happen if the euro fell apart. There is no denying the serious cracks that opened up in Europe during 2003. Europe's internal fractures suggest that the vision of a United States of Europe may remain a pipedream.

Disunity could lead to accelerated reforms. To be sure, a Disunited States of Europe may be just what the doctor ordered for Europe's ailing economy. Countries pursuing the right tax, welfare and labor market policies will be rewarded with capital inflows and stronger growth. Eventually, a competitive process of dynamic benchmarking should result in a less regulated and stronger economy.

But a disunited EU has other important consequences for financial markets. The country factor is likely to become more important in determining bond and possibly equity prices. Growing divisions on budgetary policy could significantly widen government bond yield spreads between the more and the less virtuous countries.

Also, a disunited Europe would likely lead to increased political pressures on the ECB to create higher inflation. Even the most independent central banks are not immune to the political environment.

Leaving the EMU would be costly both politically and economically for the seceding country. Most important, currency redenomination would not easily apply to cross-border contracts. Foreign creditors could demand that contracts be honored in euros. Thus, if a country wanted to introduce a new currency in order to depreciate it against the euro, it would face rising foreign debt servicing costs. A country might still conclude that the benefits of reintroducing a national currency outweigh the costs. Suppose, for example, that the "stability consensus" within Europe weakens further. If so, a country with a high preference for price stability, say Germany, might conclude that it wants to introduce a new Deutsche mark that would be internally more stable and externally stronger than the euro.

Moreover, the technical and practical hurdles for reintroducing a national currency are lower than generally presumed. First, the national central banks still exist and are fully operational. Second, the bulk of the reserves still reside with the national central banks. Third, payment systems in the euro area are still national.

Fourth, even the euro notes and coins have been issued by the 12 national central banks, not the ECB, and can still be easily traced to their national origin. If a country wants to reintroduce a national currency, it could simply use its existing euro notes and coins as legal tender until the new national money has been minted and printed.

I would not be surprised if the euro traded significantly lower and euro-zone bond yields significantly higher in 6–12 months' time as these risks are discounted in the financial markets.

Joachim Fels
Economist

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This is an edited and updated excerpt from "Euro Wreckage?" by Joachim Fels, dated January 22, 2004. For a copy of the full article, including important information and disclosures regarding Morgan Stanley, please see www.morganstanley.com/ourviews or contact 1-800-962-1343. This article does not provide individually tailored investment advice and has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. It was based on public information, and Morgan Stanley makes no representation that it is accurate or complete. Estimates of future performance are based on assumptions that may not be realized. Investments and services are offered through Morgan Stanley & Co. Incorporated, member SIPC. Morgan Stanley and One Client At A Time are service marks of Morgan Stanley. © 2004 Morgan Stanley.

PRODUCTIVITY

WILL THE MIRACLE LAST?

How long can the economy sustain its remarkable gains in productivity? Quite a while, say some leading economists

FOR THE PAST THREE YEARS, through recession, corporate scandals, terrorist attacks, and massive federal budget deficits, the U.S. has turned in one of the best productivity performances of all time. As companies used new technology and improved business practices to squeeze more output from fewer workers, nonfarm business productivity soared at a 4.5% annual rate. That unexpectedly strong showing—double the 50-year average of 2.2%—propelled robust profits as the economy came roaring back.

But that's all history now. Companies have begun hiring again, and the reported growth in productivity is inevitably going to slow. The current pace of hiring suggests companies will create 2.5 million to 3 million jobs over the next year. That could cause productivity growth to dip to 2% or even lower.

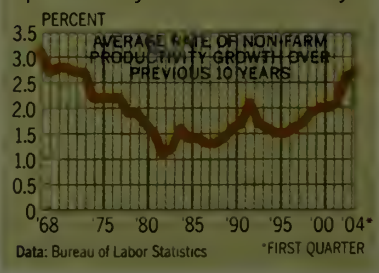
Such year-to-year fluctuations in productivity are normal. However, Federal Reserve Chairman Alan Greenspan and other policymakers face a tricky task: Amid all the noise, they must try to discern the economy's underlying rate of long-term productivity growth—what economists call the "sustainable" rate. Obviously, 4.5% per year is not sustainable, but is a long-term rate of 3.5%, 2.5%, or perhaps an even slower pa

The answer has huge implications the economy and Fed policy. That's *BusinessWeek* turned to the experts. surveyed nine of country's lead economists, from a bel laureate to one the main skeptics of 1990s' New Econo looking for their l judgment about h fast the productive pabilities of the eco my are growing.

The results are s prisingly upbeat. average, the nine ec omists estimate productivity gro

THE BIG PICTURE

Economists look at 10-year averages to smooth out business cycle distortions and see productivity trends more clearly



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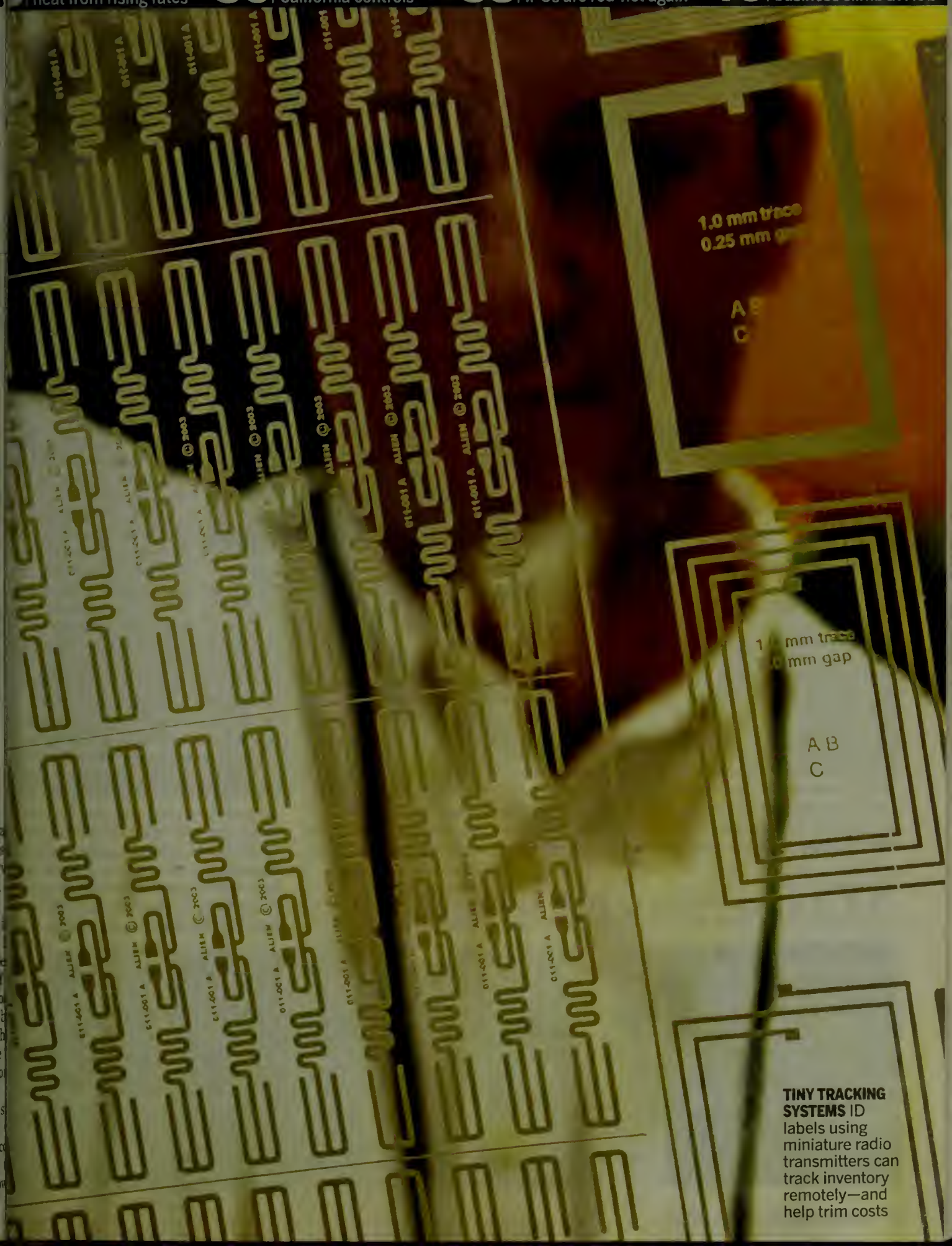
40 Ad sales and global business climb at AOL



TINY TRACKING SYSTEMS ID labels using miniature radio transmitters can track inventory remotely—and help trim costs

trend to be 2.75% annually over the next few years. The outlook exceeds what most optimists thought possible just a few years ago. "The forces that have driven productivity growth since 1996 still seem to be operating," says Martin N. Baily, an economist at the Institute for International Economics and head of the Council of Economic Advisers under President Bill Clinton.

HYDRAULIC LIFT A Parker Hannifin worker in Illinois

MAJOR CONSEQUENCES

THIS HIGH LEVEL of sustainable productivity growth, if true, carries major consequences for future Fed policy that go far beyond the quarter-point hike in interest rates on June 30. Higher underlying growth in productivity will help Greenspan keep to his strategy of slow and measured interest-rate hikes, since the economy can grow more quickly without igniting inflation.

What's more, sustainable productivity growth is a key indicator of the long-term health of the economy. Over the past 10 years, productivity has risen at a 2.7% rate, translating into higher incomes for most Americans and higher stock prices. If productivity continues to rise at the same rate—as the economists expect—the same should hold true for the future. Moreover, strong productivity growth makes it easier for society to pay for defense, Social Security, and Medicare as well as manage the federal budget deficit.

Still, productivity growth is tough to forecast, and it's no sure bet it will stay at a robust 2.5% or higher. Because productivity is driven by intangible factors such as technology and changes in work practices, the underlying trend can shift sharply, as it did upward in the mid-1990s and downward in the mid-1970s. So some economists are wary of being too confident about big gains. "I would bet on 2.5% productivity growth for the next few years," says George A. Akerlof, the 2001 winner of the Nobel prize in economics. But Akerlof warns that "the number is very uncertain since we have not had this very high productivity growth for so very long."

That's why several of the economists surveyed gave a wide range for their best and worst cases. For [illegible]ple, Alan B. Krueg[illegible] Princeton University [illegible]mist who was chief [illegible] Dept. economist unde[illegible]ton, estimated susta[illegible] productivity growt[illegible] 2.9%, but noted that it [illegible] be as low as 1.5% or a[illegible] as 4%.

With its cyclical n[illegible] productivity growth [illegible] slow considerably for [illegible] or more as companies [illegible] up on hiring. "Anyone [illegible] looks at the profits expl[illegible] should be predicting b[illegible] growth and below-[illegible] productivity growth [illegible] now on for at least the [illegible] two years," says North[illegible]ern University econ[illegible] Robert J. Gordon. A s[illegible] of bad numbers may [illegible] nerve Wall Street and [illegible] sure Greenspan to [illegible] rates faster.

Yet Gordon, a sk[illegible] about the New Econon[illegible] the '90s, now sees trend [illegible]ductivity growth at a [illegible] 3.1%. Even if product[illegible] slows to 2% over the nex[illegible] years, the four-year ave[illegible] from 2002-2006 could be 3% a year, w[illegible] is "entirely possible and pretty impre[illegible] by historical standards," says Robert [illegible] a Stanford University economist [illegible] heads the National Bureau of Econ[illegible] Research committee responsible for [illegible]ing the beginning and end of recessio[illegible]

Among the economists surveyed, [illegible] high estimate was sustainable produc[illegible]ity growth of 3.3% per year from Ha[illegible] Varian, an economist and former dea[illegible] the School of Information Managemen[illegible] Systems at the University of Californi[illegible] Berkeley. But even the lowest estimate [illegible] 2.25% to 2.3%—from Kevin A. Hasse[illegible] the American Enterprise Institute [illegible]

A Consensus Is **Upbeat**

BusinessWeek asked some of the country's leading economists to project what they see as sustainable productivity growth over the next few years. Here are their answers:

3.30%	3.10%	3.10%	2.90%	2.75%	2.50%	2.[illegible]
HAL VARIAN University of California at Berkeley, former dean of the School of Information Management & Systems	**ROBERT GORDON** Northwestern University, a leading productivity expert	**ROBERT HALL** Stanford Univ., head of the National Bureau of Economic Research Business Cycle Dating Committee	**ALAN KRUEGER** Princeton University, Labor Dept. chief economist under President Clinton	**MARTIN BAILY** Institute for International Economics, chairman of Council of Economic Advisers under Clinton	**GEORGE AKERLOF** University of California at Berkeley. Nobel prizewinner	**DAVI WYS** Stanc & Poc chief econc

INTEREST RATES

That Starter Home May Be A Nonstarter

It's practically an article of faith among many housing industry execs. Some Federal Reserve officials are believers as well: The housing market will be able to weather the rising interest-rate cycle that the Fed kicked off on June 30 because the economy is strong and the job market is healthy. By this reckoning, buoyant growth will boost wages and salaries, giving home buyers the extra money they need to cover their increased borrowing costs and so buttress housing.

Well, hold on. It turns out that it would take a sizable increase in income to offset the effect of rising interest rates on housing affordability. What's more, first-time home buyers, who are already stretching themselves financially to purchase their houses, look particularly vulnerable now that borrowing costs are increasing. And if those buyers disappear, their absence could have an outsize impact on the market because they provide the new demand that gives the market its juice. The bottom line: Housing may be in for a rougher ride than some optimists think.

A quick look at the housing affordability index compiled by the National Association of Realtors shows why. The index is widely considered by economists the best measure to judge how much house the average American can pony up for. It assumes home buyers fork out a 20% downpayment and don't spend more than 25% of their monthly income on mortgage payments.

HOW AFFORDABLE? A pinch for first-time buyers

So what will happen if mortgage rates rise by 1¼ percentage points by the end of next year, as the Realtors and other analysts project? Turns out median family income would have to climb nearly 15% to keep houses as affordable as today. Yet incomes rose just 3% over the past year.

To be sure, the average family that already owns a house would still have enough dough to move if they chose to, even if interest rates rise as much as expected. But first-time home buyers, the lifeblood of the market, could find themselves out of luck. According to the Realtors' index, a 1¼ percentage point increase in mortgage rates would mean that median-income first-time buyers would need an income of $42,000 to qualify for a typical $145,000 starter house. Yet today the median income is only $31,000. They could always borrow more, of course, or opt for an adjustable rate mortgage to try to keep payments down. But if they don't want to go that risky route, they might have to settle for a fixer-upper or a condo. Or they could be priced out of the market altogether.

The wild card in all this is what happens to house prices as interest rates rise. House prices have increased sharply over the past few years, as the market has boomed. In some areas on the East and West Coasts, the price hikes have been so sharp that first-time buyers already find it tough to find something affordable. Add to that increased borrowing costs as interest rates rise, and a recipe may be brewing for some pretty steep price declines. While nationwide price drops in housing are rare, history suggests that regional markets can suffer hard landings.

Put it all together and it's not a pretty picture. Perhaps the best that anyone can hope for is that the housing market stagnates for a while until incomes rise enough to make homes more affordable again. But after the recent boom times, a flat market could feel pretty crummy.

–By Rich Miller in Washington

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ale W. Jorgenson, a renowned produc-
ity expert at Harvard University—show
ry healthy gains. By comparison, in the
o decades from 1975 to 1995, produc-
ity growth averaged only 1.5%.

Not only has technology fueled those
g productivity gains in the last decade,

0%	2.25%	2.75%
SON	**KEVIN HASSETT** American Enterprise Institute, director of economic policy studies	**AVERAGE FORECAST**
me n ivity th		Data:

there's every indication that info-tech advances are proceeding apace. Wal-Mart Stores Inc., already is starting to require its big suppliers to attach miniature radio-frequency ID transmitters (RFID) to shipments. Tracking inventories by radio will boost productivity by enabling Wal-Mart to run its mammoth distribution and warehouse network with even fewer people and to trim costs by lowering inventories. Eventually, much of the retail industry is likely to follow Wal-Mart's lead, meaning such gains will spread.

Even in traditional manufacturing, similar gains continue. Parker Hannifin Corp., a $7 billion maker of hydraulic, pneumatic, and fuel equipment, has lifted productivity by reorganizing its factory floor and using technology effectively. Plant managers used to send orders for raw materials to a central purchasing department. Now, factory workers place orders directly with suppliers via touch-screen computers at their work stations.

Gains are spreading from the biggest, most advanced companies to smaller operations. "The dramatic reduction in IT prices means that small companies now have access to technology that only big companies could afford a decade ago," argues Varian. "That will lead to big productivity gains at small and medium-size enterprises in the years ahead."

No one can offer any guarantees of future productivity growth. But right now it looks like the economy can grow for the next few years with plenty of new jobs, even as inflation stays tame. Now that's a productivity miracle. ■

–By Michael J. Mandel, with Heather Green in New York and Michael Arndt in Chicago

AUTO MAKERS

CALIFORNIA RULES, DETROIT QUAKES

Carmakers are balking at proposed regs that would cut CO_2 emissions

CALIFORNIA IS SCARING the daylights out of the auto industry once again. Having long led the nation in mandating everything from reduced emissions to greater protections for car buyers, regulators in the Golden State are pushing for new rules that would cut carbon dioxide emissions—a key component of greenhouse gas—from all cars sold there before 2015 by 30%. Since CO2 can't be filtered from auto exhaust, the only way auto makers will be able to meet that goal will be to make a big, costly leap in fuel efficiency. Effectively, the California Air Resources Board proposal forces them to boost gas mileage on cars sold locally by 30% to 40%.

Naturally, auto makers don't like the proposed rules—especially since such populous states as New York tend to follow California's lead on auto regulations. And with the period for public comment on the new regs set to end on July 7, the auto makers are gearing up to get them watered down or killed. In all likelihood, their main attack will come in the courts: The auto makers are contemplating a lawsuit arguing that California has no jurisdiction to regulate fuel economy, since that falls under federal control. Moreover, they argue that CO2 is not a pollutant and therefore can't be regulated (box).

While it could be years before the legal debate plays out, for now there appears to be plenty of political momentum behind the proposed rules, from Governor Arnold Schwarzenegger on down. "Climate changes resulting from auto emissions have already had a dramatic impact on the environment of this state," says Fran Pavley, the state assemblywoman who authored the bill seeking the CO2 curbs. "We have to stop the auto companies from continuing to do it."

If California prevails, could auto makers meet the proposed rules by 2009, when their phase-in would start? CARB says they already have the technology to make big strides in fuel economy. It cites everything from high-tech transmissions and fuel controls to improved aerodyn ics and using turbochargers to boost efficiency rather than horsepower.

NUMBERS GAME

BUT GETTING TO the 30% reduction not be as easy as CARB asserts, claim makers. They say building the technol into a range of models would take lo and cost more than CARB assumes. M over, focusing on fuel economy would quire a dramatic cultural change am power-loving consumers and by an in try used to building big vehicles with p ty of horsepower. Says Ford Motor Co. William C. Ford Jr.: "We're in the busi of giving customers what they want, they're saying, 'We want bigger engi

What Price **Better** Fuel Economy?

California's proposed clean-air rules aim to improve fuel economy by up to 40% between 2009 and 2014. It's doable, but auto makers face big hurdles:

COST WOES

The domestic auto makers are aga n in the but only Ford's $700 profit per vehicle in th comes close to covering the estimated $1.0 vehicle it would cost to meet California's ta

MARKETING CHALLENGE

Technologies such as turbocharging can he carmakers meet the rules. But they'll have t persuade consumers to pay up for fuel effic rather than horsepower.

BILL VARIE/CORBIS

and bigger vehicles.'"

Not surprisingly, auto makers are balking at the extra investment that would be required to boost gas mileage. CARB asserts that building a car that puts out 30% less CO2 would add $1,000 to manufacturing costs. Auto industry execs dispute that number. David E. Cole, executive director of the Center for Automotive Research, says $1,000 will deliver a fuel savings boost of just 20% to 25%. What's more, auto makers insist the CARB estimate ignores research and development costs. One Japanese auto exec says it would cost millions to test even existing technologies for durability and performance in a variety of vehicles.

For the Big Three, ere's another fear: They could once ;ain lose out to their surging Japanese ri- ls. Toyota, Honda, and Nissan may be no ore eager to front the costs of adapting to e new regs, but their stronger profitabil- / would make them better able to do so if rced. Detroit carmakers, while profitable ;ain, aren't making enough per-car prof- to cover the estimated $1,000-per-vehi- e cost. Ford comes closest, at an average $700 per vehicle; General Motors and hrysler earn much less on their vehicles. loreover, while the Japanese already have number of fuel-efficient vehicles, the Big hree have focused disproportionately on g SUVs and trucks, where they get most of eir profits. To meet the fuel economy re- uirements, they might have to sell fewer of these gas-guzzling vehicles in California, if they can't make them more efficient.

It doesn't help that Detroit is behind in bringing some of the technologies to market. Honda and Toyota widely use variable valve timing, which is more efficient and cleaner than traditional fuel controls. But GM and Ford have it in only a few cars; Chrysler doesn't have it at all. It would take two to four years just to develop a new engine with the technology and years more to work it into new product plans and get plants tooled up to make the vehicles. To get the technology ready for 2009, the first year of California's proposed rules, carmakers would have to start work immediately, says Mark M. Chernoby, Chrysler Group's vice-president for advanced vehicle engineering.

HOLD THE HORSES

THE BIGGER CHALLENGE may be shifting focus from power and size to fuel economy and CO2 emissions. Current consumer tastes have carmakers falling over one another to sell cars with lots of horsepower, plenty of luxury amenities, and spacious cabins. Since 1981, average fuel economy has improved just 1%, to 20.8 mpg. Meanwhile, the average vehicle has 93% more horsepower and is 24% heavier, according to the U.S. Environmental Protection Agency. Even Honda Motor Co. used variable valve timing and a bigger engine in its Accord sedan to more than double its horsepower since 1989, leading to a slight drop in fuel economy. Harnessing technologies for fuel efficiency instead would require "a shift in design priorities," says John M. DeCicco, a senior fellow at the nonprofit Environmental Defense organization, "as much a cultural change to the industry as an engineering challenge."

Selling fuel economy to buyers would also require a big shift in marketing. One of CARB's suggested technologies is turbocharging, which gives a car added boost. Carmakers have long sold it as a sporty option to add horsepower. But CARB says carmakers could downsize an engine, say from a V-8 to a V-6, and add a turbocharger to improve fuel economy and emissions. That would work, but consumers see turbo and think speed, not efficiency. Says Chrysler's Chernoby: "Today, the market is telling us that it's not willing to pay for those trade-offs." If California implements its new fuel economy rules, however, auto makers and consumers may have no choice. ■

–By David Welch, with Kathleen Kerwin, in Detroit and John Carey in Washington and Ronald Grover in Los Angeles

MOG
akers say
liance will
oo much

UFACTURING LAG

ke four years or more to design cars with l-saving hardware and get plants tooled up l it. That could make it tough to meet the ase of the regulations in 2009.

H-UP TIME

nd Honda already put such fuel-saving logies as variable valve timing in many s. GM and Ford have them in only a le Chrysler hasn't introduced them.

ENVIRONMENT

CO2: The Debate Heats Up

Is carbon dioxide an air pollutant? That will be the key issue in any legal challenge to California's proposed rules to reduce CO2 in auto exhaust.

Carmakers argue that carbon dioxide is naturally occurring and nontoxic. That, they say, means it's not a pollutant—which, more importantly, means California can't cite its clean-air laws to restrict CO2. They point, too, to an Environmental Protection Agency ruling last summer in which the agency reversed a Clinton-era rule declaring CO2 a pollutant and said that it had no business regulating it.

The California Air Resources Board sees things differently. High levels of

END RESULT CO2 can't be filtered

greenhouse gases, largely carbon dioxide, the board argues, are a major contributor to global warming. CO2 emissions, CARB adds, have "significant adverse effects" on ecological systems, human health, and the economy.

The CO2 question is already the subject of a federal lawsuit. A group, including 12 states and 14 environmental outfits, sued the EPA last year, challenging the agency's decision not to regulate CO2. The plaintiffs argue that the Clean Air Act instructs the EPA to act against threats to the "public welfare."

Lawyers say a win or loss in Washington could make the California dispute moot. Either way, plenty of debate is in store. And all that hot air means—yup—more CO2.

–By Kathleen Kerwin in Detroit

ACE PHOTO AGENCY/ROBERTSTOCK.COM

COMMENTARY

BY TIMOTHY J. MULLANEY

Pop! Goes the Offering—Again

Conservative pricing and pent-up demand from investors are fueling jumps

ONE THING MOST INVESTORS sure don't miss about the late-1990s stock market boom is those first-day price pops for initial public offerings. Small investors were often burned, buying high as well-connected players who could get in at the offering price unloaded shares at huge profits. For startups, the memories are no better. They liked the buzz when their shares soared after going public—then realized they had raised too little cash to survive the bust. Selling new issues for less than the market was willing to pay in first-day trading cost companies about $35 billion in 1999 alone.

Well, the pops may be coming back. Although the average first-day boost for the 66 IPOs this year that closed at $8 a share or higher has been a relatively modest 12.2%, some 14 companies have risen 25% or more. A few are even edging toward the look and feel of those frenzied boom days. Software-over-the-Web leader Salesforce.com Inc. gained 56% in initial trading on June 2, for example, while online jeweler Blue Nile Inc. rose 38% when it went public on May 20, and educational-software company Blackboard Inc. booked a 43% hike on June 17.

Why are IPOs soaring again? In the case of Salesforce, a leader in the up-and-coming business for productivity-enhancing software, its IPO was the most anticipated tech offering of 2004 this side of search engine Google Inc.'s planned IPO. And though the company isn't talking, setting a conservative price was clearly in its interest: After Salesforce CEO Marc Benioff had been forced by the Securities & Exchange Commission weeks earlier to delay the deal following a lengthy interview he gave to *The New York Times*, there were clearly risks in setting a price so high that it might diminish enthusiasn the stock. The $11-a-share price helped rekindle investor citement and quickly turned talk away from Benioff's gaffe. Salesforce paid dearly for the buzz: In selling 11.5 million sh for $11 instead of the $17.20 first-day close, it left about $70 lion on the table.

HYPER IPO
Benioff (center) saw Salesforce.com's offering spike 56%

That isn't likely to be fatal to the company or its invest Finance professor Kent L. Womack of Dartmouth Colle Tuck School of Business notes that shares in companies that joy a first-day pop of 10% to 60% perform better than ot IPOs over the first year of trading. The worst performers those that rise over 60%. Besides, leaving some cash on table has its benefits. Womack says a IPO pop boosts trad volume and attracts analyst coverage.

In an otherwise sideways marl there's plenty of enthusiasm for IP Mutual funds are taking risks on th because fat returns are harder to f than in 2003. Indeed, unlike the ' bubble, institutions, not small invest are leading the surges. Laszlo Birinyi whose firm Birinyi Associates I tracks bulk trading, says early Salesfo trades came from big players, includi one that bought nearly 10% of the fered shares in one trade. Institutio also led Blue Nile's jump in its fi weeks, when shares doubled from t $20.50 IPO price.

There's another reason big public- fering pops are staging a comeback. D spite piecemeal reforms to tackle the abuses of the bubble yea little has changed. Issuers still make pricing decisions based incomplete or flawed information: Investment banks and co panies selling stock meet with dozens of institutions, collect ders for shares based on a tentative price range set before t roadshow, then set a price the night before an IPO. But at the e of the day, that still gives companies only a limited view of wh price investors will pay or how high the issuer can push the pri without risking the deal. As Salesforce quickly discovered. ■

IPOs: Overall, a **Slow Creep** Back Up

AVERAGE FIRST DAY RETURN

1997	1998	1999	2000	2001	2002	2003	2004
13.80%	21.76%	70.89%	57.29%	14.15%	8.90%	12.10%	12.20% YEAR-TO-DATE

Data: Jay R [illegible] University of Florida [illegible]

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—Joe Schick, VP Finance, Expedia, Inc.

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THE INTERNET

AMERICA ONLINE GETS CLICKING

Yes, subscriber rolls are down, but ad sales and the global business are up

LAST YEAR, THE REVIVAL that lifted the rest of the online industry left America Online Inc. in the dust. Even as a rebound in ads sent 2003 profits at rival Yahoo! Inc. spiking 123%, AOL's subscribers jumped ship in droves for low-cost dial-up competitors or broadband providers. Ad revenue sank 40%, to $787 million, and federal investigators continued to probe AOL's past ad deals for accounting irregularities. As operating earnings before depreciation and amortization fell 2%, to $1.5 billion, Wall Street started betting that Time Warner Inc. would ditch AOL the first chance it got.

But AOL's date with the dump has been postponed, if not canceled. On June 24, Time Warner paid $435 million in cash to buy Advertising.com Inc., a leading online-ad-placement company that should help boost AOL's ad revenue. "Our emphasis is on building up the AOL business," says Time Warner CEO Richard D. Parsons.

Chalk up one for AOL CEO Jonathan F. Miller. After struggling to regain focus after its rocky 2001 merger with Time Warner, AOL is finding its footing again with Miller's new strategy: providing a menu of online services ranging from full-blown broadband service to á là carte online music subscriptions to cheap, no-frills dial-up access. "We'd gotten behind in the market," he says. "We're putting in a business model appropriate to where the world is going."

Miller hasn't yet proven that the world will order from his menu, but a rebound in AOL's advertising and global businesses will buy him time. Combined with cost cuts, that should produce the double-digit profit growth this year that Time Warner expects, says Richard Greenfield, media analyst at Fulcrum Global Partners LLC. Still, the heart of Miller's strategy—persuading customers who have signed up with another broadband provider to also buy AOL's broadband services—is a gamble. "They haven't turned the battleship around yet," says David Card, online-media analyst at Jupiter Research.

In the new world, Miller is counting on profit gains, not revenue growth, to float AOL's boat. The company's old $23.90-a-month dial-up service made for fat revenues but slimmer profits, thanks to the cost of providing network connections. New, lower-priced broadband se[illegible] will produce less revenue but highe[illegible] gins since AOL won't have to pay ne[illegible] access fees. It expects earnings fro[illegible] broadband and premium services [illegible] global sales to rise 30% to 50% an[illegible] over the next few years.

NOT JUST EYEBALLS

AN AD REVIVAL is starting to hel[illegible] the first time since 2001, ad re[illegible] should rise 11% in 2004, to $873 mi[illegible] says Deutsche Bank. Advertising [illegible] should send them up even more. It [illegible] cializes in a new results-driven appr[illegible] charging advertisers for the numb[illegible] online transactions gen[illegible] ed by ads, not just the [illegible] ber of eyeballs reached [illegible]

Meanwhile, Mille[illegible] stanching the blee[illegible] from AOL's dwindling [illegible] up base. To preserve [illegible] gins, AOL is renegoti[illegible] contracts with net[illegible] providers such as MCI [illegible] As dial-up members l[illegible] AOL can cut network c[illegible] associated with them.

That leaves Miller fre[illegible] pursue his "superstore [illegible] the Web" strategy. To m[illegible] low-cost rivals, there's a [illegible] $9.95-a-month dia[illegible] Netscape Communicati[illegible] service. For members [illegible] sidering a move to br[illegible] band rivals, there's a $14.[illegible] a-month AOL [illegible] Broadband service. H[illegible] will he persuade consum[illegible] to buy AOL's package [illegible] content and services if t[illegible] use someone else's pipe [illegible] get online? By offering b[illegible] size premium services s[illegible] as $8.95-a-month onl[illegible] music subscriptions. A[illegible] AOL is offering free samp[illegible] of content from Ti[illegible] Warner's video-on-dema[illegible] and Road Runner bro[illegible] band units. The plan sho[illegible] signs of working. In the first quart[illegible] 600,000 people signed up for the broa[illegible] band services, for a total of 3.5 million.

AOL remains a long way from a su[illegible] tained revival. But with healthier [illegible] sales, slimmer costs, and a rosier glob[illegible] outlook, Miller—and Time Warner—c[illegible] afford to throw the dice for now. ■

–By Catherine Yang in Washingto[illegible] D.C., with Tom Lowry in New York a[illegible] Ben Elgin in San Mateo, Cal[illegible]

MILLER The CEO has earned some breathing room

New Game Plan

America Online is betting its future on three small but growing businesses

ADVERTISING The purchase of Advertising.com, along with a partnership with Google, are expected to help AOL boost ad revenues 11% this year, to $873 million—the first year-over-year increase since 2001.

BROADBAND/PREMIUM SERVICES Of AOL's 24 million U.S. subscribers, 3.5 million now get broadband; at current rates, it's adding about 2 million broadband users a year. AOL has also sold 2 million á là carte premium services, such as extra virus protection and music subscriptions, that range from $2.95 to $8.95 a month.

INTERNATIONAL Having refocused on selling broadband packages to consumers, AOL Europe turned profitable last year despite heavy competition from national European carriers.

Data: AOL, Deutsche Bank

BANGLADESH Low-cost makers will get busier

ETAILING

WHEN QUOTAS END, WHO GETS THE GOODIES?

Vholesale apparel prices will plunge, but etailers may not pass on a lot of savings

FALLING APPAREL PRICES have been a big boon for consumers over the past five years. So on Jan. 1, when decades-old quotas on apparel imports from low-cost manufacturing countries ex- re, allowing a flood of ever cheaper ans, T-shirts, and sweaters from ina, India, Pakistan, and other coun- es into the U.S., shoppers can expect to g up monster savings at the cash reg- ter, right?

Well, don't be rushing out to the mall st yet. As retailers prepare for the end of e quotas, they are hotly debating just actly what the impact will be. And hile no one doubts that stores will pay arply lower prices for imported cloth- g, it's far from clear that big savings will ickle down to consumers. Instead, most pect retailers to try to hang on to most f the savings to maintain profits and im- rove margins. "In the absence of quotas, tail prices should come down, but I'm ot sure that's going to happen," says arshal Cohen, chief industry analyst at arket researcher NPD Group Inc.

Once quotas are lifted, U.S. retailers nd others who bring in garments from road are expected to consolidate more of their apparel manufacturing to low-cost, efficient producers. The big winners are likely to be China, India, and Pakistan. Until now, the quota system had made such consolidation impossible because companies could only buy a limited amount from each country. J.C. Penney Inc., for example, currently imports clothes from about 51 countries. But within two to three years, it will concentrate production in just 23 countries, says Peter McGrath, chairman of Penney's purchasing division. Likewise for Liz Claiborne Inc. Ultimately, it will trim its sourcing in half, to about 20 countries, says Bob Zane, vice-president of manufacturing, sourcing distribution, and logistics.

The upshot: Retailers will get a huge cost break. McGrath, who is also chairman of the National Retail Federation's International Trade Advisory Committee, figures wholesale prices to retailers and other importers will drop by 8% to 18% between 2005 and 2006.

Many are counting on hanging onto as much of those savings as possible. Sluggish sales and aggressive discounting in recent years have eaten into their bottom lines, leaving them little incentive to pass along lower prices. And though quotas are disappearing, rising prices for cotton and oil are pinching retailers. Also, while lower wholesale prices will help retailers bring down costs, the expected flood of cheaper imports will almost certainly spark further deflation in the apparel sector as some try to gain share by passing on the savings. Frank Badillo, chief economist at consultant Retail Forward Inc., says retail apparel prices have fallen at a 2.1% annual rate over the past five years. After quotas are gone, he expects retail prices to drop about 4% a year for the next five years.

THE STAT

-4%

Expected annual drop in apparel prices over the next five years

"SOMEONE COULD BLINK"

TO HOLD THE LINE, many retailers are planning to maintain current prices while using the cost savings to boost the quality of their apparel. "What you'll probably see is higher-quality product, but at the same price point," Joseph J. "Jay" Fitzsimmons, senior vice-president of finance and treasurer at Wal-Mart Stores Inc., said at a recent retail conference. J.C. Penney execs agree.

But the brutally competitive market won't make it easy for retailers to pocket most of their windfall. If one major player starts to lower prices, all bets are off. "Sooner or later, someone could blink and cut prices. If that happens, everyone else will have to follow," says analyst Daniel D. Barry of Merrill Lynch & Co. Concedes Liz Claiborne's Zane: "What we or our retailer does depends upon competition to a large degree."

In the end, apparel analyst Marie Driscoll of Standard & Poor's figures one-third of quota savings will be passed to consumers while retailers and manufacturers will keep another third as profit, with the remaining third reinvested in improving products. Let the countdown to a quota-free environment begin. ■

–By Stephanie Anderson Forest in Dallas, with Nanette Byrnes in New York and bureau reports

COMMENTARY

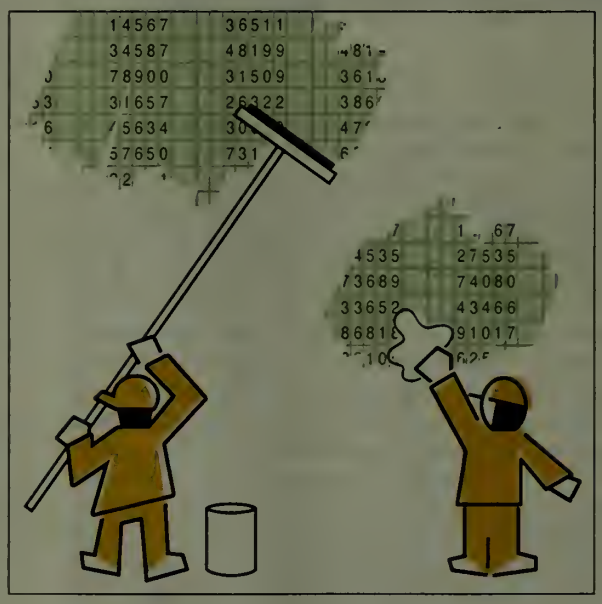
BY MIKE McNAMEE

The SEC Opens the Door–Wide

Although companies may squirm, its new disclosure policy is good for investo

WHEN ENRON CORP. collapsed late in 2001, securities lawyers asked: Where was the SEC? Turned out the Securities & Exchange Commission's Corporation Finance Div. had passed up its chance to review Enron's annual financial reports for three straight years—a critical gap when the Houston energy trader was pioneering new forms of financial finagling. The 2002 Sarbanes-Oxley reform act gave the SEC clear orders to step up its reviews of big companies' filings—and, just as important, added the accountants and lawyers needed to do the job.

Now, the SEC is putting on a final touch: Starting this fall, it will publish its comments on companies' filings—and the back-and-forth between SEC staff and corporate officials as they hammer out disputes large and small. Essentially, the SEC will be airing Corporate America's financial dirty laundry for investors, analysts, and all the public to see.



There will be plenty to air. SEC and corporate accountants often spar for months over the wording of management disclosures and financial footnotes. The 2001 annual report for Berkshire Hathaway Inc., for example, spurred a six-month exchange over the use of nonstandard financial measures and accounting for special-purpose entities at the Omaha company. Until recently, investors were clueless that such negotiations even took place.

No more. That wealth of information will now be put to good use. Reading SEC comments on sticky accounting issues in competitors' filings should help companies get their own figures right the first time. Analysts and investors will get earlier warning on how companies are trying to spin their numbers. They'll also have powerful insights on financial problems that affect entire industries. "With the SEC's emphasis on oil reserves at Royal Dutch/Shell Group, wouldn't you like to see what the [SEC] staff is saying about reserve figures for other oil companies?" asks Phillip L. Brown, CEO of Washington-based C al Securities Information Inc., publisher of the LiveEdgar document service. The new openness could even make th of writing accounting rules easier: The Financial Accoun Standards Board could stick to enunciating broad princi while SEC comments build up a "case law" that reflects those guidelines apply in specific instances.

Businesses appear resigned to the change. "It's all in brave new world of transparency and disclosure," says G Hinchman, a lobbyist for Financial Executives Internation professional group for chief financial officers. Clearly, many have to make adjustments. Companies used to routinely do SEC requests to amend their filings, promising instead to re SEC-demanded fixes on their next report. Now, both compa and the SEC might prefer fixing disclosures rather than having to plain why they weren't changed.

SEC insiders say Chair William H. Donaldson initiated disclosure plan unveiled on June But credit also goes to a small b of companies that three years began prying loose SEC comm letters. Using requests filed under Freedom of Information Act, s firms as Global Securities Infor tion and analysts SEC Insight Inc Plymouth, Minn., turned up iss that companies had tried to doc including a few undisclosed SEC forcement probes. The weight those FOIA requests—6,915 in first nine months of fiscal 2004, v over double the pace two ye ago—pushed the SEC to publish of its review letters. "If we've got correspondence that invest and companies can legitimately make use of, we ought to ge into their hands without the burden of FOIA," says SEC Cor ration Finance Director Alan L. Beller. The new plan, wh promises letters will be released within 45 days of a revie completion, will be faster and more dependable than FOIA.

Companies and bureaucracies will still have many ways obfuscate. The SEC, for instance, will let companies filter th responses for confidential material, leaving it up to readers challenge whether omissions are justified. And skeptics say policy needs a bigger push from the top. "If Donaldson were support it in a speech, we'd be a lot more confident," says Jo P. Gavin, president of SEC Insight. True enough. But even w its low-key launch, the open-book approach is a good start.

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EDITED BY MONICA ROMAN

HEADLINER

GLENN TILTON

FLYING ON FUMES

For bankrupt UAL, parent of United Airlines, there was no charm the third time with the Air Transportation Stabilization Board. On June 28, CEO Glenn Tilton got the bad news: The panel again rejected the company's request for federal loan guarantees, even though the amount had been cut to $1.1 billion. Case closed.

Now Tilton, a former TexacoChevron vice-chairman who took the helm at UAL in 2002, must go back to employees and vendors for another round of painful cost-cutting. That's after already slashing $5 billion annually, about a third of United's expenses. He may even have to attack one of labor's sacred cows—pensions—hurting worker morale at the nation's second-largest carrier.

With sky-high fuel costs and rapidly growing discount carriers holding down fares, Tilton doesn't have much room to maneuver. Some question whether he can keep his job if a major equity investor comes to the rescue. For now, he has no choice but to roll up his sleeves and get back to work.

–Wendy Zellner

A BURDENED HALLIBURTON

The bad news just keeps flowing from **Halliburton**. This time it has nothing to do with controversial government contracts in Iraq. On June 29, the Houston-based oil services giant said it would take charges totaling $815 million in the second quarter because of further setbacks on an offshore project in Brazil and lower-than-expected asbestos insurance recoveries. The $615 million write-off related to asbestos was expected. But analysts were caught off guard by an additional $200 million charge for the troubled drilling platform project, which to date has racked up at total of $715 million in charges. Although the charges are considerable, **Standard & Poor's** analyst Andrew Watt says the company has "adequate liquidity" to handle them. Halliburton had $1.9 billion in cash as of Mar. 30.

FREDDIE'S FRENETIC YEAR

RICHARD SYRON

Steady Freddie is no more. The era of predictable earnings by **Freddie Mac**, the housing finance company, is officially over with its June 30 revelation that 2003 earnings plummeted 52%, to $4.9 billion. But it was no ordinary year, notes Chairman and CEO Richard Syron, who took over after last year's accounting scandal forced out several top officials. Freddie's earnings are likely to be volatile in the future, too. Much of the earnings hit came from lower values on derivatives used to hedge interest-rate risk. Freddie previously used accounting tricks to smooth over such swings—tricks that new management, new auditors, and a newly aggressive regulator won't condone.

NORTEL WON'T ROLL ITS OWN

Nortel Networks is leaving the manufacturing game. Singapore-based outsourcing giant **Flextronics International** will acquire Nortel's plants in Canada, Brazil, France, and Northern Ireland. By selling the plants, the Canadian telecom equipment giant will reap between $675 million and $725 million. The cash will come in handy as Nortel cleans up its accounting mess. The company said it would update the restatements of financial results from previous years by late July. It will also release limited preliminary audited results for the first half of 2004 by mid-August.

OFFICE DEPOT'S OFFENSIVE

The office-supply superstore wars are heating up. **Office Depot** is planning its first major invasion of the Northeast, long dominated by industry leader **Staples**. After several years of modest store growth, Office Depot now plans to open 100 stores annually, with about half of those in the Northeast. It is also moving to a new store design that will feature smaller, better organized, and more colorful stores. It's [illegible] effort to close the gap w[illegible] Staples, which has revar[illegible]e many stores, and has be[illegible] posting stronger sales. B[illegible] with a market value less [illegible] half that of Staples, Offic[illegible] Depot has a ways to go.

ET CETERA...

» **Fidelity Investments** Vi[illegible] President Charles Fishki[illegible] will head the **SEC**'s new [illegible] Office of Risk Assessmen[illegible]

» A U.S. appeals court rejected Massachusetts's [illegible] to overturn **Microsoft's** antitrust settlement with [illegible] federal government.

» **Bank One** will pay $90 million to settle allegation[illegible] of improper mutual-fund trading.

CLOSING BELL

Research in Motio[illegible] is on the move. Shares of the company, which makes BlackBerry e-mail wireless devices, rose 14.2[illegible] to $91.36, on June 30. The reason? RIM posted higher than expected earnings and raised its forecast, thanks to strong subscriber growth.

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ITED BY MIKE McNAMEE

Will *Fahrenheit 9/11* Singe Bush?

RE, MICHAEL MOORE MAY have won an Oscar for his 2002 film, *owling for Columbine*. And the French film jury at Cannes this ring may have fawned all over his latest effort, *Fahrenheit 9/11*. ut few imagined that the filmmaker from Flint, Mich., would try play kingmaker in the 2004 election.

Now that Moore's relentless screed ainst President Bush has broken box-fice records, that scenario is haunting nservatives, whose clumsy efforts to ppress the movie have only increased its peal. So could this be the first Presiden-l election ever decided by a film? Not ely, but Moore is creating buzz—and a litical machine—that can only hurt ish in a razor-thin contest.

Moore is straightforward about *Fahren-it*'s goal: to deny Bush reelection. The ovie itself defied expectations and ossed $24 million on its debut weekend June 25, establishing it as the biggest nmusical documentary ever. Moore's stributor is prepar-g to more than uble its screens to 000.

Lefty Moore can ank conservatives r some of that boffo ception. The right-ing group Citizens nited petitioned the ederal Election ommission on June 4 to restrict adver-sements for the ovie, charging that ey are political ads. thers pressured the-ter owners to shun e movie, only generating more attention.

BUSH BASHERS Michael Moore is getting support from Howard Stern

But the bad news for Bush supporters oesn't stop there. Moore plans to use the ovie as an organizing tool. On June 28, he onducted a virtual town hall meeting with e liberal group MoveOn.org. Moore ex-orted the 55,000 listeners who logged in r turned out at 4,600 MoveOn parties round the country to sign up as foot sol-iers in an anti-Bush crusade. Once people e his flick, said Moore, anyone who once supported Bush and the war in Iraq "will feel deceived and betrayed, and they will respond with a vengeance."

Media Influence

THAT'S A STRETCH. The movie tenaciously attacks the President for his decision to invade Iraq, his fealty to wealthy supporters, and his pre-September 11 inattention to terrorism. But Moore is largely preaching to the converted. While a *BusinessWeek*-Ipsos poll of 1,002 adults during *Fahrenheit*'s opening weekend found that an enormous share of respondents, 77%, had heard about the movie, only 17% of Republicans were inclined to see it, vs. 62% of Democrats and 40% of independents. Few said viewing the film would influence their vote. Still, says Ipsos pollster Janice Bell, "people tend to underestimate how much they are influenced by the media."

One of the movie's biggest boosters is shock jock Howard Stern, formerly a rabid Bush supporter. Stern claims to have turned on the Prez after reading Moore's book, *Dude, Where's My Country?*—an epiphany that closely coincided with the Federal Communications Commission crackdown on so-called airwaves smut. A poll conducted for the centrist New Democrat Network claims that 4% of the electorate are swing voters who regularly hear Stern's anti-Bush rants. MoveOn is targeting undecideds, too. Members are being asked to take fence-sitters to *Fahrenheit* or invite them over to watch the DVD. The release date? This fall—just before the election. ■

–By Paul Magnusson

CAPITAL WRAPUP

NADER: MISSING FROM THE BATTLEGROUNDS

DEMOCRATS FRET that Presidential candidate **Ralph Nader** could take critical votes from **John Kerry** this fall. But they might be overreacting. At the end of June, Nader had a spot on the ballot in only one of nine states that are complete toss-ups—Florida. In five others, the campaign hasn't even hired state coordinators to collect signatures.

Spokesman Kevin Zeese points out that Nader has until August or September to file in such battleground states as Iowa, Minnesota, and Wisconsin. And standards are low: In Wisconsin, just 2,000 signatures can get a candidate on the ballot. Where access rules are tougher—as in Missouri and New Hampshire—the campaign will hire professional petition gatherers.

Then the real battle begins: Democrats say they'll sue, as they have in Arizona, to keep Nader off the ballot in every state. Zeese is disgusted. "Sending lawyers into every state to undermine the efforts of tens of thousands of voters is undemocratic," he says.

WHO'S PAYING THE FREIGHT IN IRAQ?

REMEMBER HOW the Bush Administration once claimed Iraq would bankroll its own reconstruction? Well, so far it has. The $24 billion Washington earmarked for reconstruction has been so snarled in red tape that only $3 billion had been disbursed by Apr. 30, according to a June 28 General Accounting Office report. Meanwhile, $11 billion in Iraqi funds were spent—even though the country's oil patch is in disrepair. Seized assets have helped tide over the effort—but the U.S. will soon have to pony up.

FINANCE

INSIDE THE BANK OF ENGLAND

It's one of the most admired central banks. Now it faces a housing bubble

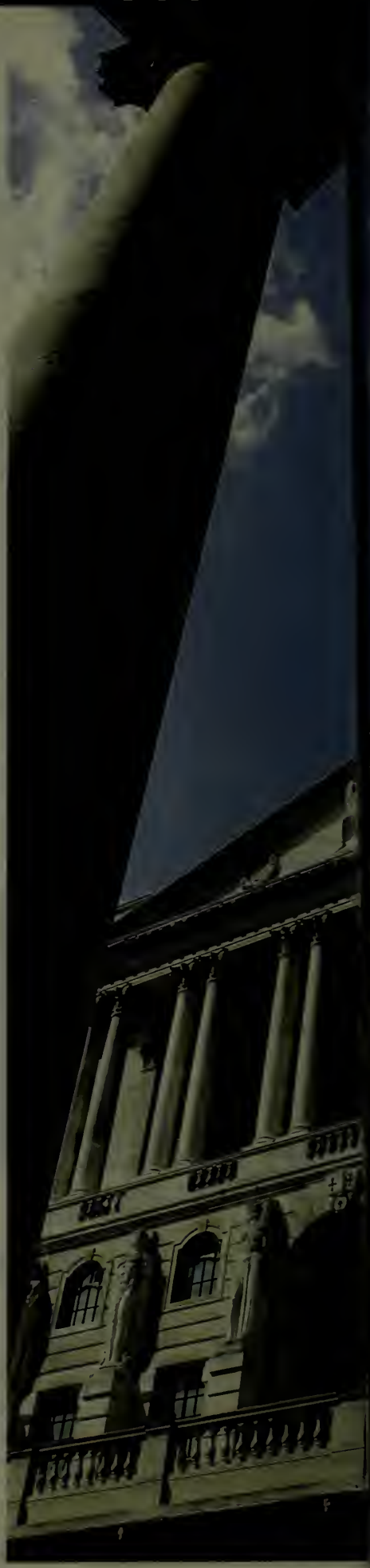
JOHN BARTLETT PULLS HIS blue sedan up beside a red brick building in a run-down industrial park outside of Birmingham, England. Inside, he gets a warm handshake from the finance director of a $35 million maker of specialty industrial fasteners. Bartlett, the Bank of England's man in the West Midlands, is making his annual call on one of his 600 to 700 contacts. Over tea in a modest meeting room, Bartlett goes through his checklist. How is the company doing? It is booming. And investment plans? The company has just ponied up $1.8 million for new machinery and a lab. After an hour, Bartlett is off again—this time up the road to visit a car dealer. The dealer reports tougher going: Manufacturers are pushing more and more cars on the dealers, and it's getting harder to meet sales goals each month. In June, sales started dropping off "just when your friends at the bank pushed up rates," the dealer jokes.

KING The BOE governor is considered a principled boss

Bartlett and 11 other regional agents around Britain are emblematic of the way Mervyn King and his predecessor Eddie George have energized the Bank of England. Being a regional rep used to be a dead-end job. But that was before the bank gained authority to set interest rates in 1997. Formerly, that was the Chancellor of the Exchequer's job, and he listened more to the siren song of politics than sober economic observation in setting monetary policy. But no more. Now that the bank has sole authority over interest rates, the agents are among King's most important eyes and ears. Their findings are distilled into a report for the rate-setting Monetary Policy Committee each month—and MPC members say the agents' on-the-ground reporting is a valuable supplement to reams of numerical data.

King and his colleagues at the BOE are paying particularly close attention to the soundings of Bartlett and others because the British economy is entering a risky phase. In the past seven years, the BOE has been one of the world's most successful central banks—perhaps second in effectiveness only to the U.S. Federal Reserve. Since 1997, when the BOE finally became independent, it has managed rates so nimbly that Britain has not seen a single quarter of contraction. Growth in that period has averaged 2.6%, vs. 3% for the U.S. Inflation has been benign: 2.3%, the same as in the U.S. While Britain's average growth has not increased that much in the past decade, the economy has avoided the deep recessions of the early 1980s and 1990s.

This steadiness has won King, a self-



(L TO R) NICK RAY/THE TIMES; GRAHAM BARCLAY/BLOOMBERG NEWS

IN THE CITY The bank has managed rates nimbly

assured academic with a wry sense of humor and a soft spot for soccer, a top reputation in the world of central banking. The BOE itself is considered by many a model—more so even than Alan Greenspan's Fed, which many economists see as a one-man band. Predictable and effective—that's what King likes to be. "For much of the postwar period, British macroeconomic policy was too exciting for comfort," he says. "We should aim to be boring."

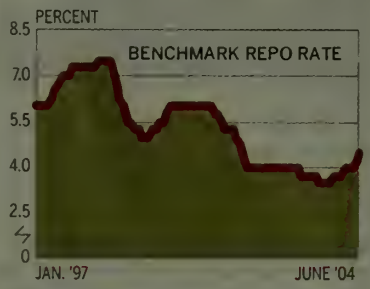
But all the field reports indicate that King's life could get uncomfortably exciting very soon. By his own admission, the era he dubbed "NICE"—for Non-Inflationary, Consistently Expansionary—is lurching to an end. King thinks the economy is near the limit of what it can produce in both manufacturing and services—a situation that normally pushes up prices. The British labor market is tightening, he notes, and the world interest-rate cycle has turned. Growth is still solid and consumer spending robust, but things are getting choppy. Perhaps most menacing, real estate prices in Britain are soaring—15% at the latest annualized rate.

The BOE has already been hiking rates, moving into a more hawkish position last November. Some critics, though, say the bank hasn't moved fast enough and that the only way out is a major tightening and possibly a recession. A big spike in rates—every increase of a full point slows gross domestic product growth by half a percent—would make most Britons feel poorer very fast. Three-quarters of all mortgages are adjustable on a monthly basis.

Such a scenario would evoke the end of the last big property boom in the early 1990s, when housing prices crashed. So a real estate bust and a hard landing would make the bank's admirers wonder if the BOE is as skilled as claimed—or the beneficiary of a stretch of uncommonly good economic luck. King and his colleagues think the much sounder macroeconomic framework that Britain has put into place gives the country a good chance of avoiding the vicious cycles of boom and bust that once plagued the economy. Prime Minister Margaret Thatcher privatized chunks of the economy and defanged big labor, making Britain a much more flexible economy.

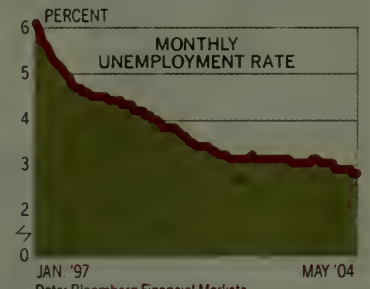
THE BOE'S TRACK RECORD

Britain's Central Bank acts early and often to adjust interest rates...



...which has kept the British economy roaring along...

...and has slashed unemployment in Britain to record lows



Data: Bloomberg Financial Markets

But the struggle to balance the competing interests of growth and inflation in the months ahead will test the innovative techniques King and others have fashioned for the bank. "The Bank of England is the state of the art at this moment," says Adam S. Posen, a former Fed official now with the Institute of International Economics think tank in Washington. The BOE's nine-member Monetary Policy Committee is much more nimble and accountable than the 18-member governing council of the European Central Bank—and it includes four outside executives.

Central bank watchers also applaud the bank's 2% inflation target, which is set by the Chancellor, and which holds the MPC to account not only on the upside but on the downside. In this regime, producing no inflation is considered as big a problem as producing too much. Targeting is partly designed to prevent bankers from killing growth by being overly hawkish. A recent study by Charles Wyplosz, professor of economics at the Graduate Institute for International Studies in Geneva, and two colleagues, found that 21 central banks target inflation. The BOE itself borrowed the concept from the Reserve Bank of New Zealand. "But a small bank would never influence the world of central banking like the BOE has," Wyplosz says. Even some Fed policy-

CHARTS BY LAUREL DAUNIS-ALLEN/BW

HARROD'S Spending is strong—for now

makers, led by Governor Ben S. Bernanke, want the U.S. to adopt an inflation-targeting regime—though Bernanke prefers to target a range, from 1% to 2%.

Britain's central bank has catered to the needs of investors as well. It publishes the minutes of the MPC's monthly debate 13 days after it meets, which gets the bank's thinking to the markets before the committee meets again. In contrast, the Fed doesn't publish its minutes until six weeks after it meets—and no one ever knows how the ECB board voted.

NEITHER HIGH NOR LOW

GREENSPAN, FOR HIS PART, has resisted inflation-targeting. Supporters of his approach note that while the BOE has avoided the lows of the U.S. economy, it has never achieved those thrilling highs that have created so much wealth in the U.S.—and that have usually been followed by fairly shallow recessions. Likewise, the bank has never had to act as a de facto custodian of the global financial system as the Fed has, turning on a dime to cut rates in critical moments like the 1987 crash and September 11. And the BOE has never had to deal with as many unpredictable developments. King himself admits that there is little New Economy effect in Britain—and no surge in productivity whose effects are so difficult to measure. Greenspan has ably dealt with all these phenomena.

But there's no denying King's stature among financial policymakers. The Birmingham native has been a key player in modernizing Britain's once-amateurish economic policymaking since he became chief economist at the bank in 1991. And he is enough of a political animal to have successfully shepherded ideas such as inflation-targeting through the dog-eat-dog world of British politics. King still keeps his lines open to Chancellor of the Exchequer Gordon Brown through monthly working breakfasts—though both men say rates are never discussed.

Like other central banks, King and the BOE are now contemplating new rate rises. The MPC forecast in May that inflation, now under 1.5%, would exceed its 2% target over the next two years if interest rates weren't hiked. The economy is likely to clock growth above 3% this year, but Britain's non-inflationary growth rate is considered to be closer to 2.75%. Sensitive to the threat of overheating, the BOE has jacked up interest rates four times, to 4.5%, starting last November. Most analysts think the rates will go up to 5% by yearend.

Another source of potential upward pressure on rates is Brown, who, by some accounts, has undergone a conversion from penny-pinching Iron Chancellor to money-gushing Big Spender. In a mid-June speech in Brown's presence, King gently prodded the Chancellor to deliver on his assurances that the public finances would "swing back to what is known in the trade as a sustainable fiscal position."

King is far from pessimistic about the outlook—merely, he says, realistic. In the seven years since l Minister Tony Blair and Chanc Brown made the bank indepen Britain has definitively shed its reput for economic mismanagement. Sta and the robust economic growth it ha tered have been an enormous boon to and Brown. Pro-business Conser chancellors in the past, such as Nigel son and Norman Lamont, both unsuc fully urged their bosses, Margaret Th er and John Major, to give the ban independence from politicians. Instea advised monetary policy robbed That of many of the benefits that might been expected during her tenure. Rate by Chancellor Lawson in 1987 and 1 for instance, overstimulated the econ contributing to the long recession of early 1990s.

Some critics say the central bank rates too much in the slowdown of 2 2002—and they predict trouble ahea a result. Other observers are less simistic. Ben Broadbent, an economis Goldman, Sachs & Co. in London, that while house prices may be ri fast, the rest of British economy is no the midst of an out control boom as it before the last recess in the early 1990s. stead, spending has b in line with inco growth. One issue is t the economy relied consumption to avoid cessions in 2001 a 2002 when investm and exports plummet The bank, he says, n hopes to achieve m balance. "Even if t housing market d weaken" the massi 20% or so that Goldm is forecasting, Broadbe doubts "that will ha catastrophic effects," b cause business inves ment and exports a picking up. The Brit have not had an econon ic catastrophe for som time. It's up to the BOE old in years, but young i its independence—t make sure one doesn happen now. ■

–By Stanley Reed i London with Rich Mille in Washington and Davi Fairlamb in Frankfu

On Target

Some 21 central banks use variants of the BOE's inflation-targeting model. Here are some of them, and the inflation rates they are targeting.

RESERVE BANK OF AUSTRALIA	2-3%
BANK OF BRAZIL	±2.5%
BANK OF CANADA	2%
BANK OF ISRAEL	1-3%
BANK OF KOREA	3%
BANK OF MEXICO	3%
NATIONAL BANK OF POLAND	<4%
SWISS NATIONAL BANK	<2%

Data: Fraca Bloomberg W Central Banks in Inflation? Expectations Targeting Central Banks

-COMMERCE

EUROPE HEADS FOR THE E-MALL

J.S. companies dominate as Internet ales explode across the continent

SABINE KRÜGER IS NO INternet newbie. The Frankfurt-based financial-communications consultant uses e-mail and search engines constantly and scours online travel sites r bargain vacations. But it wasn't until a w months ago that she got sucked into e addictive pleasure of online marketlace eBay. Shown the site by a colleague, he started bidding on antiques and ound herself checking constantly on her rogress. "I got completely hooked," rüger laughs.

Krüger, 46, has lots of company. Ebay's iant German Web site attracts 17.4 milon visitors per month—up 20% in the ast year—according to researcher ielsen//NetRatings. Growth is even ster in countries later to get on the Net. ince May, 2003, eBay's traffic has umped 51% in France and nearly douled in Italy. With Internet connections nd broadband penetration growing cross the continent, Europeans are geting serious about buying online. Reearcher IDC figures there were 67 million nternet shoppers in Western Europe by he end of 2003, and they spent $20 bilion in the fourth quarter. Amazon.com lone sold more than $2 billion of merhandise outside the U.S. last year—an stimated three-quarters of it in Europe—nd will open a Scottish distribution cener later this year. By the end of this year, DC predicts, nearly a quarter of all Europeans will shop the Net. "Europe is a particularly fertile area for us," says William C. Cobb, senior vice-president for international at eBay. He predicts that the company's European business ultimately will equal that in the U.S.

Other types of Web sites are flourishing, too. In the past year, European visitors to earch engine Google soared 65%, to 62 million a month. Microsoft's MSN portal saw 72% growth, to 61 million visitors, says Nielsen. Travel giant Expedia just fired up new Web sites in France and Italy. "Despite the boom and bust of the dotcoms, Internet usage has continued to grow," says Geoff Sutton, European general manager at Microsoft MSN Europe.

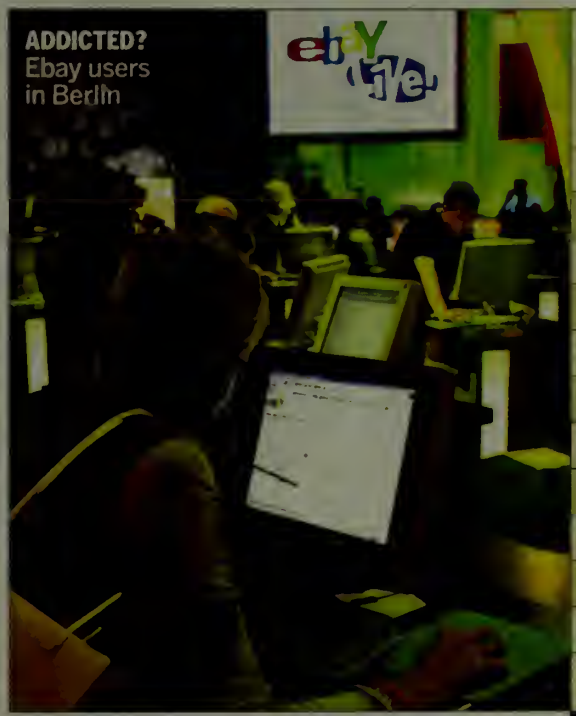
For European policymakers eager to promote an Information Society, there's one letdown in this new Net love affair. Most of the top online brands in Europe are American companies that have parlayed easier access to capital and success in their home market into dominance of the European Web. "There's no European equivalent to Yahoo," says Olivier Beauvillain, an analyst in the Paris office of New York-based Jupiter Research. The U.S. players enjoy huge economies of scale. Microsoft's deep pockets help it fund aggressive marketing that national rivals can't afford. MSN, Yahoo, and Amazon are able to develop technologies such as Web e-mail and spread them abroad. "We think it will be increasingly difficult for local competitors to develop new services," says MSN's Sutton.

DISHING IT OUT

THAT'S NOT STOPPING the Americans from spending big to lock in their lead. Ebay has just opened a new operations center in Ireland for its PayPal Inc. online-payment subsidiary that could eventually employ 800 people. Google is adding workers at its Irish hub and other European offices. Yahoo! Inc. paid $577 million in March to buy Kelkoo, Europe's largest shopping-comparison site. And on June 22, Seattle digital-media company Loudeye Corp. paid $20.7 million for Europe's largest digital-music provider, Bristol (England)-based OD2.

Of course, Europe can sometimes dish it out. Amazon's overall European sales are growing, but it is cutting back its French operation in the face of fierce competition in France from local champions FNAC.com, Cdiscount.com, and bookseller Alapage. That's a rare stumble. For the most part, the Americans succeed by hiring local managers, customizing sites, and signing up local partners. For Europeans, that may end any dreams of building their own Web giants. But the consumers flocking to American-owned sites are just happy to get great deals. ■

–By Andy Reinhardt in Paris, with Robert D. Hof in New Orleans



ADDICTED? Ebay users in Berlin

America.com

U.S. companies prevail among the top 10 Web destinations in Europe

COMPANY	AUDIENCE REACH* 5/04	COUNTRY
1. Google	36.7%	U.S.
2. MSN	35.7	U.S.
3. Microsoft.com	33.3	U.S.
4. Ebay	20.7	U.S.
5. Yahoo!	19.7	U.S.
6. Wanadoo**	13.2	France
7. Tiscali**	10.1	Italy
8. Lycos Europe**	9.8	Spain
9. Amazon	9.6	U.S.
10. T-Online**	9.3	Germany

*percent of total online population that visits the site at least once per month
**Web sites owned by ISPs or telecom companies

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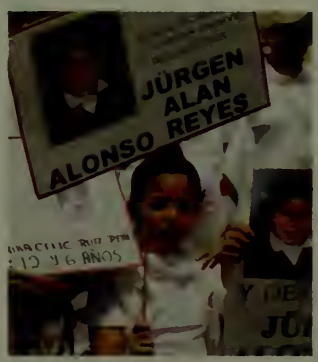
ITED BY MICHAEL S. SERRILL

Mexico's Middle Class Takes to the Streets

ESTIMATED HALF-MILLION Mexicans walked silently through wntown Mexico City on June 27 to demand better police pro-tion and prosecution of criminals responsible for a surge of lnappings and murders in the capital and other cities. They rried placards with photographs of slain loved ones. A ldle-aged man held aloft a sign reading y Country Has Been Kidnapped" as rs trickled down his face. When they npleted their 2½-mile march to the in plaza, the protesters released hun-ds of black and white balloons and g the national anthem. Then the thun-ous bells of the 400-year-old Metro-itan Cathedral clanged mournfully for minutes.

t was as impressive a piece of political ater as Mexico has ever seen. Now, big question is whether the momen-n unleashed by the march will be nneled into a potent civic movement t will help Mexico address the crime blem—and kick start a ger effort to hold Mexi-s politicians account-e. Many think the scale the march could signal arrival of a new grass-ts force, just as the gov-ment's clumsy response a devastating 1985 rthquake led to the cre-on of citizen-action ups that paved the way political change.

There's plenty of anger fuel a movement. Al-ough the march was fo-sed on incompetent and rrupt law enforcement, e protesters were also demanding dra-atic change in the way government op-ates, from improving education to odernizing the economy. Four years o, Mexicans put an end to 71 years of e-party rule when they booted out the ng-ruling Institutional Revolutionary rty (PRI) and elected political outsider cente Fox of the National Action Party AN) as President. But the PRI still con-ls half the seats in Congress, and the result has been gridlock—and a rising tide of popular fury that finally expressed itself on June 27.



PROTEST Will the movement have staying power?

No Politicians, Please

MOST IMPRESSIVE was the sophistication of the protesters. The march was a well-organized show of force by a segment of society that traditionally has not been activist: middle-class and upper-middle-class taxpayers. They summoned people to the march through the Internet and community meetings. The organizers, a potpourri of citizen groups led by Mexico United Against Criminality, warned political parties to stay away so as not to "contaminate" the protest. Volunteer marshals wearing green T-shirts urged marchers not to shout political slogans and instead remain silent to honor the crime victims.

Now the politicians are scrambling to respond. President Fox said the march was a clear sign authorities had to do more. That's not enough for the organizers, who with presidential elections two years away know now is the best time to wring concessions. They're meeting with Fox to deliver a list of demands for better police training and tougher criminal penalties. "We're going to follow up, because society demands it," says march instigator Eduardo Gallo. His daughter was kidnapped and murdered—and when police failed to find her killers, he tracked them down and led police to their hideout. That's not the way the system should work, the marchers say. What might someday be called the June 27 movement is determined to change it. ■

–By Geri Smith in Mexico City

GLOBAL WRAPUP

IS MARTIN GOING OVERBOARD IN CANADA?

CANADA'S LIBERAL Party and **Prime Minister Paul Martin** managed to squeak out a victory in the June 28 national election, but disgruntled voters handed them a minority government. The Liberals took the electoral hit amid controversy over misused public funds and general complaints over the party's reputation for arrogance. Now a chastised Martin pledges to pump new funds into improving the country's strained public health-care system, revamping social programs, and speeding up the immigration process. Some business leaders fear Martin, a fiscal hawk when he was Finance Minister, is abandoning restraint to cater to interest groups. And he may also have to cater to both left and right to get anything done in Parliament.

STEPPING UP THE PRESSURE ON YUKOS

A MOSCOW court ruled on June 29 that oil company Yukos must pay $3.4 billion in back taxes and fines. Yukos doesn't have the money, which means court bailiffs can seize its property. But most observers expect a deal with the government to stave off bankruptcy. The obvious solution would be for authorities to allow Yukos to sell its stake in Sibneft, a smaller Russian oil company. But even if it succeeds in paying the huge fine, that's unlikely to be the end of the matter. Further tax claims could follow. Many believe the pressure will end only when Yukos' major shareholder—imprisoned tycoon **Mikhail Khodorkovsky**—sells his stake.

IDEAS McCallister has slowed the rise in health costs at Humana

Vital Signs At Humana

Its CEO has revived the insurer, but can he sell a bold health plan to clients?

WHEN MICHAEL B. McCallister took over at Humana Inc. four years ago, the Louisville-based health insurer was on the critical list. Its commercial business was bleeding red ink, and it faced the potential loss of government contracts that constituted a third of its revenues. In the ultimate irony, the health insurer was suffering from a problem all too familiar to its customers: soaring employee health-care costs. After years of double-digit increases, McCallister was facing an expected 19.2% surge in his company's health costs in 2001.

That's when the 52-year-old former hospital administrator began his radical surgery. He quickly exited the 15 states where Humana's commercial group was weakest and moved to secure its grip on lucrative government contracts. And to rein in his own spiraling health-care costs, McCallister restructured Humana's health plan to coax 4,800 headquarters workers to manage their own health-care spending before the company's coverage kicked in. In doing so, McCallister hoped to sensitize his own employees to the true costs of medical care—and force them to be more discriminating in their use of high-cost specialists, emergency rooms, and procedures like CAT scans. He recalls: "I told my employees, 'I'm not going to be your father anymore. I'm going to set the table for you to make your own health decisions.'"

McCallister's triage paid off. Bolstered by a subsequent increase in Medicare reimbursemen reversed the $ million loss Hu suffered the ye fore he became with a healthy $228 million pro 2003. That sharp improvement sen mana's shares soaring from around February, 2000, to as high as $24 las uary—earning the company a spot o BusinessWeek 50 ranking of Ame top-performing large companies. A Humana's own health costs, the com claims that the cost of insuring its l quarters workers rose just 4.9% the year, and 2.7% the next year—well b the 12% national annual average fo past three years. "You have to give credit for turning the ship around," Abbott Keller, chief investment offic Kestrel Investment Management C which owns 1.6 million Humana sh

PRICING PRESSURE

BUT DESPITE A strong first quarter year—in which profits rose 117%—s investors clearly are betting that Mc lister can't sustain his turnaround m longer. Indeed, analysts believe Hum and other health insurers will see newed pressure from corporate clien give back some of their recent pr through price reductions. Humana c also face political pressure to make s lar concessions in its Medicare contr which still account for 22% of reven Humana's own warning that seco quarter profits would be slightly below pectations on pricing pressures sent shares tumbling, to about $16 today.

That's why McCallister is embark on his boldest gambit date: persuading his cor rate clients to adopt same "consumer-drive health policies Hum successfully deployed th years ago. The move n represent McCallister's b shot at ensuring Human independence at a ti when larger rivals like Anthem and Ur edHealth Group are gobbling up regio players like Humana. Even if he's s cessful, those giants may still target H mana—which has one-eighth the me ber base of UnitedHealth—for takeov analysts say.

The theory behind the new medi plans is that the only way to break the s ral of ever-rising health-care costs is give employees a direct incentive to duce their expenses. Says McCallist "We've tried everything else—legislati

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restrictions, turning doctors into risk-takers—but the one thing we haven't done is turn to the actual users of health care and power them up." Under the plans, workers get a basic level of annual medical coverage—say, $500 per family member. When those funds are exhausted, workers are subjected to a deductible, perhaps $3,000 per family. That sounds steep, but it's offset by the fact that employees are no longer paying monthly premiums for their coverage. Once the deductible is met, the employer generally provides full coverage of additional expenses for the year.

BEHAVIOR SHIFTS

McCALLISTER IS so confident he can deliver results like those at his own company that he's promising to cap any cost increases at 9.9% in the second year after adoption of Humana's SmartSuite plan. "They're the only insurer offering a plan like this that's willing to put their money where their mouth is," notes James R. Mueller, president of Frank F. Haack & Associates Inc., a Wauwatosa (Wis.) insurance consultant and brokerage. But some analysts fear that Humana may be pricing too aggressively. "The more that they make cost guarantees, the greater the risk that they may make underwriting mistakes," warns Charles Boorady, an analyst at Smith Barney Citigroup. Critics also worry that to save money, consumers may stint on care—creating bigger health problems, and bigger bills, down the road.

McCallister dismisses such concerns, arguing that the biggest savings come from some simple shifts in consumer behavior—from costly specialists to primary-care physicians, and from branded drugs to cheaper generics. Humana does its part, offering Internet-based tools to help members compare health plans and monitor their expenses.

For all of McCallister's proselytizing, companies have been slow to embrace the new policies. Of the 3 million members in Humana's commercial accounts, just 225,000 have enrolled in SmartSuite. "There's a lot of inertia," McCallister admits. "But we're going through exactly what HMOs went through when they were introduced in the 1980s."

Humana probably doesn't have the decade or so that it took for HMOs to catch on. McCallister has to hope that his customers see the light. Otherwise, Humana will remain vulnerable to getting swept aside in the rapidly evolving health-care industry. ■

–By Dean Foust in Louisville

COMMENTARY

BY ALEXANDRA STARR

It Takes More Than A Little *Español*

What's hampering Bush's efforts to woo Hispanics

WHEN THE BUSH Administration u veiled get-tough measures aimed cutting off the flow of cash to Cuba June, the political calculations were o vious. Conservative Cuban America are a core bloc for the President in the crucial state Florida, and hard-liners in the community have lo been infuriated that the money Cubans send to their r atives indirectly helps prop up the regime of Fidel Cast

But the new restrictions—limiting Cuban Americans' trips to Havana and restricting the gifts and cash they can send to family members—didn't win the bravos the Administration had been banking on. "Fidel Castro is not a good man," says Ana Karim, a 32-year-old pastor of a Mennonite church in Richmond, Va., who regularly visits an aunt and two ailing uncles in Cuba. "But I get very, very offended when someone tells me how to engage with my family." Indeed, 64% of younger Cuban Americans—those who arrived after 1985 or who were born in the U.S.—favor unrestricted travel between the U.S. and Cuba, vs. 32% of the old guard, according to a March poll by Florida International University. With the younger Cuban Americans gaining in numbers and clout, "on a net basis, [Bush] may very well lose politically by this," says Philip Peters of the Lexington Institute, a free-market think tank in Arlington, Va.

Policy miscues and border crackdowns could cost Bush votes

The backlash is just another example of the fine line politicians must walk in appealing to the nation's largest and fastest-growing minority group. The President—who speaks a rudimentary *Español*—has made appealing to Latinos a central p of every campaign since his first run governor of Texas in 1994. In the 20 race, Bush garnered about 35% of the H panic vote—slightly better than aver for the past several Republican nomin

But Bush's efforts to raise his par support among Hispanics have hit so rough spots. National polling on Hisp ic political attitudes is hard to come by March-June 2004 survey by the Pew Ce ter for People and the Pr found 53% of Hispanics vored Senator Kerry vs. 4 for President Bush. But b cause the poll was conduct only with English-speake it is not a comprehens snapshot. Latino leade meanwhile, say Hispan are disillusioned with so of the President's polici "[Bush has] lost support the community," says Ant nio González, president the William C. Velásquez Institute, a no partisan think tank in Los Angeles. Hi panics "thought he would do great thin with Mexico and on education. Those e pectations haven't been realized."

That could be problematic for the GO Latinos make up about 13% of the U. population, although they are vastly u

represented at the polls. Many are not izens, and even those who are registered vote do not turn out regularly: Fewer an half of eligible Hispanics voted in the st Presidential election—or some 6% of e total. Still, if the election is tight, they uld make a difference in states such as izona and New Mexico, where Hispan- s account for 16% and 32%, respectively, registered voters. And Republicans will ed to improve their standing with His- nics in order to prevail in the future. The President and Karl Rove have been ry consistent in targeting Latinos. They now that in the long run they cannot af- rd for Latinos to go the way of African mericans," says Roberto Suro, director of e Pew Hispanic Center.

Republicans on every level recognize e Hispanic potential. The Bush-Cheney mpaign is spending liberally on Span- h-language television. The Republican ational Committee orchestrated voter registration drives in New Mexico and California around Cinco de Mayo, Mexico's May 5 national holiday. And about a year ago, New York's state party unveiled an outreach center in a heavily Dominican—and Democratic—neighborhood of Manhattan. Officials say 400 Latinos have registered to vote at the Washington Heights office since March, with the majority pledging their support to the GOP.

Border Skirmish

ONE IS A 32-YEAR-OLD lifelong Democrat, Raul Acosta, who was changing his party registration to Republican on June 24. Acosta says the party's emphasis on entrepreneurship and conservative social values resonate with his community. "We want to own our own businesses," he explains. "And we are very conservative. Just ask our grandmothers."

Reaching out to Hispanics is more complicated than small biz and family values, though. Luis Martinez stopped by the Republican outreach office to check on his registration—but his vote, he declares, is going to be in the Democratic column. "Why has Bush spent all of this money on a war when we have so many needs at home?" Martinez asks.

As Bush has tried to woo Hispanics, his own party sometimes gets in the way. In January, the President floated the idea of making it easier for Mexicans to enter the U.S. as guest workers, with no promise of permanent residency. His approach angered anti-immigration conservatives without winning many points with Latino organizations.

The plan was never sent to Congress—though some Republicans are still holding out the prospect of immigration reform. On June 27, according to *The Arizona Republic*, Senator John McCain told a Phoenix conference of the National Council of La Raza, a nonpartisan civil rights group: "The human tragedy that is taking place in Arizona and across our border must be stopped. There's a demand to fill jobs that Americans won't do." But Hispanics remain underwhelmed. "We were glad the immigration discussion was reinitiated after September 11," says Ernesto Saldaña of the National Association of Latino Elected Officials. "But there needed to be a firmer path to amnesty."

Bush also hopes to lure Latino votes with his No Child Left Behind reforms. Yet Latinos don't believe the tougher standards come with sufficient new funding, according to Sergio Bendixen, president of Bendixen & Associates, a Coral Gables (Fla.) pollster who specializes in the Hispanic electorate and market. "You hear over and over in focus groups that Latinos feel public schools are underfunded," he says. "Latinos may like [Bush] personally, but they are very disappointed in his performance on the issues that impact the quality of their lives."

Republicans insist they're on the right track. Education is Hispanics' No. 1 priority, they say, and Latino parents will respond to Bush's efforts to make schools more accountable for the performance of minority students. They're also counting on the President's personal appeal—including what even Democrats acknowledge is a rapport with Mexican-Americans—to bolster his Latino vote. But that will take Bush and the GOP only so far. Figuring out a policy mix that doesn't alienate conservatives yet appeals to a broad swath of Latinos will be as tough as getting Hispanics to show up at the polls. ■

–With Paul Magnusson in Washington

NO CIGAR Younger Cuban Americans nix Bush's efforts to restrict cash flow to Castro's Cuba

the vanishing mass market

New technology. Product proliferation. Fragmented media. Get ready: It's a whole new world. BY ANTHONY BIANCO

O MOST OF US, TIDE IS AS FAMILIAR AS HOME. LAST YEAR, mericans bought some $2 billion worth of Tide, which has nked as the country's biggest-selling laundry detergent ever nce Procter & Gamble Co. took it national in 1949. If ever a rand epitomized the great, one-size-fits-all mass market, it is ide, right? Wrong. Or so says Procter & Gamble itself. James . Stengel, P&G's global marketing officer, insists that his comany's bulging portfolio of big brands contains "not one massarket brand, whether it's Tide or Old Spice"—or Crest or ampers or Ivory. "Every one of our brands is targeted."

In the boom decades after World War II, it was P&G more an any other company that put the mass in marketing, relyg on TV commercials and print ads to flog its standardized ares from coast to coast. Along with Coca-Cola, McDonald's, eneral Motors, Unilever Group, American Express, and many ther consumer-products giants, P&G now is standing mass arketing on its head by shifting emphasis from selling to the ast, anonymous crowd to selling to millions of particular conumers. "You find the people. You are very focused on them," engel says. "You become relevant to them."

McDonald's now devotes a third of its U.S. marketing budget to television, compared with two-thirds five years ago. Money that used to go for 30-second network spots now pays for closed-circuit sports programming piped into Hispanic bars and for ads in *Upscale*, a custom-published magazine distributed to black barber shops. To sharpen its appeal to young men, another of its prime target audiences, McDonald's advertises on Foot Locker Inc.'s in-store video network. The company zeroes in on mothers through ads in women's magazines such as *O: The Oprah Magazine* and *Marie Claire* and on Web sites like Yahoo! and iVillage Inc. "We are a big marketer," says M. Lawrence Light, McDonald's chief marketing officer, echoing Stengel's disavowals. "We are not a mass marketer."

For marketers, the evolution from mass to micromarketing is a fundamental change driven as much by necessity as opportunity. America today is a far more diverse and commercially self-indulgent society than it was in the heyday of the mass market. The country has atomized into countless market segments defined not only by demography, but by increasingly nuanced and insistent product preferences. "All the research we're doing tells

Picking the target carefully

Sending the right message to the right people is tricky work. Here's how some of the biggest marketers are handling it.

The latest American Express ad campaign starring longtime spokesman Jerry Seinfeld began not on television but on the company's own Web site. The two, four-minute "Webisodes" co-starring an animated Superman have pulled more than 2 million visitors in through AmEx' Internet portal. "The changes we are making are in line with the changes consumers are making, like spending time in front of the computer instead of the TV set," says John Hayes, the chief marketing officer of American Express. A few weeks ago, AmEx started running the first Web site in conjunction with TBS reruns of *Sex and the City*, a series beloved by the same **young urban professional crowd** that made Seinfeld such a hit.

In a widely noted speech year, Coke President Ste Heyer declared that Cok moving "away from broa as the anchor medium" "experience-based, access-driven mark Cokemusic.com is a promising example future that Heyer had in mind. This fluid interactive site lets visitors mix their own tracks and submit them to peer review. W million registered users averaging 40 mi visit, Cokemusic.com has quickly becom **third-most popular Web site among teen** response "has been off the charts," notes Baines, a Coke marketing executive. "And haven't really even started to market to th

us that the driver of demand going forward is all about products that are 'right for me,'" says David Martin, president of Interbrand Corp. "And that's ultimately about offering a degree of customization for all."

At the same time, the almost-universal audience assembled long ago by network television and augmented by the other mass media is fragmenting at an accelerating rate. The mass media's decline is an old story in many respects; prime-time network ratings and newspaper circulation have been sliding since the 1970s. What's new is that the proliferation of digital and wireless communication channels is spreading the mass audience of yore ever-thinner across hundreds of narrowcast cable-TV and radio channels, thousands of specialized magazines, and millions of computer terminals, video-game consoles, personal digital assistants, and cell-phone screens.

In the 1960s, an advertiser could reach 80% of U.S. women with a spot aired simultaneously on CBS, NBC, and ABC. Today, an ad would have to run on 100 TV channels to have a prayer of duplicating this feat. Adding a few Web sites would help, but not even the biggest new media conduits—not Home Box fice, not Yahoo, not AOL Instant Messenger, not even X-Box likely to ever match the ubiquity of the Big Three network their prime. "Monolithic blocks of eyeballs are gone," decla Eric Schmitt of Forrester Research Inc. "In their place is a p petually shifting mosaic of audience microsegments that for marketers to play an endless game of audience hide-and-see

TIPPING POINT

THIS IS A COMPLEX, HIGH-STAKES game for its players, w include many of America's largest companies. Figuring the right way to send the right message to the right person the right time is difficult work. It is also risky, not unlike hu ing game birds with a high-powered rifle instead of a shotgu If you miss, you miss entirely—an alarming prospect for co panies accustomed to measuring progress in minuscule gai of share of the mostly mature and fiercely competitive co sumer-products markets.

izer

For decades, the big pharmaceutical makers have ranked among the largest advertisers on network TV. However, last year, or the first time launched a new prod- pax—without any TV advertising at all. is a prescription medicine for migraine e relief. Pfizer identified **active young s as the prime target group** for Relpax usted its media mix accordingly. "They ning to the radio in the car, [going] on rnet late at night, or reading a magazine et moment," says Dorothy L. Weitzer, a arketing vice-president. "They are not g TV."

P&G

Like many packaged-goods companies, Procter & Gamble is becoming much choosier in its use of TV advertising to back mature brands. Look at Tide, which P&G has extended into a family of 14 finely differentiated products—"Clean Rinse Liquid," "Deep Clean Liquid," "Liquid Laundry," and so on. From 1999 to 2003, P&G cut its spending on TV commercials for Tide by nearly 16%, to $69.4 million, according to TNS Media Intelligence/CMR. Tellingly, Tide advertising became much more targeted as it diminished. Spending on network TV plummeted 75%, to $25.3 million, even as **outlays for Hispanic TV nearly doubled,** to $12.4 million.

On balance, the dawning era of micromarketing holds great omise for consumer marketers and, by extension, the U.S. onomy. By adding hugely to the overall supply of advertising ne and space, the proliferation of new communications chan- ls can be expected to tamp down ad-rate inflation. The sur- isingly impressive recent results of P&G suggest that targeting ight also be a boon to corporate productivity. In 2003, P&G ent $4.4 billion, or 10.1% of sales, on advertising. In 1998, the st time its spending reached 10%, unit sales volume rose by arly 4%. Today, P&G's unit growth rate is running closer to 9%. ou can draw the inference that they are spending smarter on dvertising," says William H. Steele, an analyst at Banc of Amer- a Securities. "They are spending about the same money and tting three times the lift."

At the same time, though, the fading of the age of mass mar- ting poses a threat to the traditional mass media and their eavily ad-dependent business models. To date, network TV and s mass brethren have held tight to the lion's share of advertis- g, despite their dwindling audiences. Even as prime-time ratings fell by 41.5% from 1977 to 2003, network TV's advertising revenues rose nearly fivefold. Why keep paying more for less? For a marketer looking to build brand awareness or to convey a simple, timely message to a big swath of the country, there is no effective substitute for mass media, particularly TV. If anything, the decline in network ratings has added scarcity value to the few remaining widely watched special events like the Super Bowl and the Olympics.

However, mass media's share of advertising is declining now as marketers boost spending on more targetable, narrowcast media. "Mass is still mass, but we're nearing the tipping point," says Robin Kent, chairman and CEO of Universal McCann, a media buying agency. "Then, there will be huge segmentation." A recent study by the Wall Street firm Sanford C. Bernstein & Co. predicts that the ad revenues of narrowcast media will grow at 13.5% a year from 2003 to 2010, while the mass media putter along at 3.5%—well below the projected 5.7% gain in gross domestic product. By 2010, Bernstein predicts, marketers will spend more for advertising on cable ($27 billion) and the Internet ($22.5 billion) than on network TV ($19.1 billion) or on magazines ($17.4 billion).

"WE'RE EVERYWHERE"

IT'S NO SURPRISE THAT THE big advertising agencies also are in harm's way. Madison Avenue came of age as a content supplier to mass media and remains much better versed in making 30-second TV spots than in exploiting the interactive intricacies of the Internet. What is more, in the same way that network

When mass advertising was cheap, it didn't matter that it was so blunt an instrument

TV's dominance of media is eroding, advertising's dominance of marketing is diminishing. Marketers are increasing their spending on telemarketing, direct mail, e-mail, in-store displays, and other forms of closely targeted, nonmedia spending. Says Interbrand's Martin: "An increasingly heterogeneous marketplace requires much more one-to-one communication, instead of one-to-many communication, like advertising."

Big media companies and advertising agencies have sought to reduce their vulnerability to shifts in the flow of marketing dollars by diversifying and consolidating like mad over the last decade. "What advertisers buy is platforms to get their brand promoted, and we've got four platforms for them"—broadcast TV, cable TV, billboards, and radio, says Sumner Redstone, chairman of the multimedia conglomerate Viacom. "We're everywhere, because in this day and age you have to be where the advertisers need to be."

Meanwhile, the mass media have tried, with varying degrees of success, to adapt to micromarketing's growing momentum. There is not much that broadcast TV, the quintessential mass medium, can do to accommodate the growing demand for targeting; in essence, it is technologically hamstrung. Meanwhile, cable continues to nibble away at its broadcast rivals by adding highly specialized channels and such services as video-on-demand. According to Nielsen Media Research, the average U.S. household receives 100 TV channels, compared with 27 in 1994. The audiences attracted by even the largest cable stations remain far smaller than those of the broadcast networks. Collectively, though, cable now rules prime time, with a 52% share to broadcast's 44%, according to Nielsen Media.

Print, the oldest mass medium, has been "niching down" for decades but appears to be bumping up against the limits of its adaptability—at least when it comes to creating themed newspaper sections or demographically targeted editions of magazines. *Time*, the prototypical mass magazine, long has been able to craft an almost limitless number of ad-customized ve of its national edition. "We've done as many as 20,000 ver but that's not something we want to do every week," say lisher Edward R. McCarrick. Even so, no more than 3 40% of *Time*'s ads are targeted, on average, and McCarric not expect this percentage to increase much, if it all. "Th majority of clients want to run national ads," he says.

BELIEVING IN THE WEB

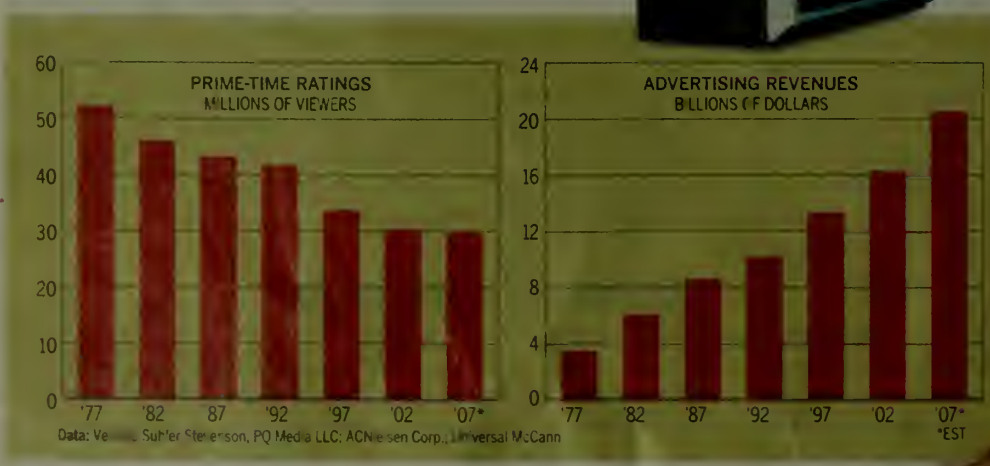
WHILE A NEW DAILY NEWSPAPER is a rarity, thousan consumer magazines have been founded over the past de including 440 last year alone, according to Samir Husni, a nalism professor at the University of Mississippi. Virtually them were born targeted. Husni estimates that only 10% 6,200 consumer magazines published today in the U.S. are eral-interest titles, down from 30% two decades ago.

One of the most financially successful of last year's cl startups is *W Jewelry*, a monthly spun out of Fairchild Pul tions' high-fashion weekly *W*, which has a paid circulati 469,000. Fairchild created *W Jewelry* by creaming off 75,0 subscribers who spend at least $60,000 a year on jewelry. with glossy ads from the likes of Cartier and Saks Fifth Av *W Jewelry* turned a tidy profit in its first year. "It used to be the mass magazines made all the money," says Mary Be Fairchild's president and CEO. "Now, it's not size that c most, but the ability to deliver someone elusive to advertis

The growing particularity of print and cable pales in parison to the infinitely expandable variety of the World Web, which now includes online versions of most every TV tion, newspaper, and magazine in the country. Spurred b spread of high-speed broadband connectivity, the Interne shaken off the effects of the bursting of the dot-com bubble

A word from our sponsors

As fewer people tune in, the networks have been charging more and delivering less



Data: Veronis, Suhler Stevenson, PQ Media LLC; ACNielsen Corp.; Universal McCann

›w is rapidly coming of age as an advertising medium. The ude banner and pop-up ads that initially defined online ad- rtising are giving way to larger and more refined formats, hile blue-chip companies like General Motors Corp. and SBC ›mmunications supplant fly-by-night dot-coms in rankings of e largest Internet advertisers.

The Web abounds in opportunities for exactly the sort of the- atic and demographic targeting that magazines and cable TV fer advertisers. However, "paid search"—the fastest-growing rm of online advertising—is an emerging form of micromar- ting unique to the Web. Type a few words into one of the pop- ar search engines and a column of paid advertisements or ponsored links" unfurls next to the search results. The fre- ıency with which an ad appears is a function of how much the vertiser paid for placement. Google and Yahoo, the Big Two search, are adding refinements that would allow paid-search vertisers to home in on Internet users by re- on or city.

In the competition for ad dollars, the new gital media—especially the Internet—are essed by two intrinsic advantages over mass edia. First, they are interactive. This capabil- enables marketers to gather reams of in- luable personal information directly from stomers and adjust their sales pitch accord- gly, in some cases in real time. Second, in part cause digital media are interactive they per- t a fuller and more precise measuring of ad- rtising's impact. "Advertisers want to exact- know what they are paying for and what they e getting for it, and you really get metrics on e Web," says David Verklin, CEO of Carat ›rth America, a media-buying agency. lients really believe in the Web now."

However, the Internet is no panacea for mi- ›marketers. The same technological ad- nces that are fragmenting the mass audience o are empowering a new class of digitally vvy consumers who compile, edit, and other- se customize the media they consume to ir own personal requirements (page 70). ompanies must recognize that they increas- gly have to engage gods and are not dealing th helpless consumers anymore," says shad Tobaccowala, an executive vice-presi- nt of Starcom MediaVest Group. "This is rticularly true of young people."

The consumer-empowering digital device t mass advertisers and TV executives fear st at the moment is the personal video corder. The PVR allows viewers to "time ift"—to watch a program when they want to ter than when it's scheduled—and to skip mmercials at the press of a fast-forward but- . Research shows that viewers watch 20% to % more television after getting a PVR, but e it to skip about 70% of ads. Today, only 4% U.S. households are equipped with PVRs, but rcom MediaVest predicts a surge to as much 30% within three years.

Network executives are soft-pedaling the R threat even as they try to blunt its impact opening their programming up wide to duct placement. Pepperidge Farm Inc. even managed to wangle a cameo role for Milano cookies in the final episode of *Frasier*. Says Leslie Moonves, who heads CBS Television Network: "Network TV needs to find a way to have another revenue stream if we're going to continue to put on the kinds of shows that we need to attract an audience."

REDEFINING STATUS

FEW OBSERVERS THINK that product placement and an accompanying trend toward sole sponsorship of network programs will ever rival advertising as a revenue source. "They're interesting, but small potatoes," says marketing guru Erwin Ephron of Ephron, Papazian & Ephron Inc. Ephron suggests that the network's best hope of maintaining the primacy of the 30-second spot would be to do the unthinkable: Slash ad rates. "Mass marketing is based upon low cost per thousands, the ability to reach people cheaply," Ephron says. "When television is cheap, you can let it do everything. But when television becomes expensive, it opens the door to less-than-mass media."

During the golden age of network TV, from the 1950s through the mid-1970s, the size of CBS, NBC, and ABC's prime-time audience grew roughly in sync with the prices charged for 30-second spots. Ratings and ad rates began diverging in the early 1980s and the gap has since widened into a canyon. By 2002, the networks' average cost per thousand viewers, or CPM, had soared to $16.79 in prime time, compared with $1.96 in 1972, according to the Television Bureau of Advertising.

The same fate has befallen print. Readership of daily newspapers fell to 55% of households in 2002, from a high of 81% in 1964. Magazine circulation sustained itself for much longer, as the dwindling readership of general-interest magazines was more than offset by the growth provided by thousands of new special-interest startups. However, the total number of consumer titles has dropped by 33% since 1999, dragging magazine circulation down by 6.9%. As with broadcast TV, though, generally rising advertising rates have powered huge revenue growth for the print media. The net result: The cost of newspaper advertising per unit of circulation has increased tenfold since the mid-1960s, while magazines have seen a fivefold rise over this period, according to investment bank Veronis Suhler Stevenson.

When mass advertising was cheap, it didn't matter much that it was so blunt an instrument. At a CPM of $10, a packaged-goods maker only had to sell four or five

Zap!

In the age of TiVo, television viewers watch even fewer ads

	ADS ACTIVELY IGNORED ON TELEVISION	ADS SKIPPED USING PERSONAL VIDEO RECORDER
Beer	4.8%	31.9%
Movie trailers	11.6	44.1
Soft drinks	21.6	82.7
Drug	32.3	45.6
Specialty clothing	33.4	62.4
Home products	41.6	90.3
Fast food	45.1	95.7
Cars (national)	52.8	68.8
Pet-related	55.5	81.5
Credit cards	62.7	94.2
Mortgage financing	74.1	94.7
Upcoming program	75.3	94.4
Unweighted average	43.1	71.6

Sur y of th largest U.S. on arkets done 2003
Data: CNW Mark Research Inc.

» It no longer makes economic sense to send a message to the many to persuade the few

units per 1,000 viewers to cover the costs of a TV ad. Chances were that the overwhelming majority of viewers watching a 30-second spot had no pressing need to buy pet food or denture cream. But they might be in the market one day and would hit the store with your brand implanted deep in their subconscious. This was the theory, anyway. It seemed to work and probably still does—if an ad is indeed memorable.

However, it no longer makes economic sense to send an advertising message to the many in hopes of persuading the few. The range of prime-time advertising has narrowed greatly over the years, leaving the network's continued financial good fortune heavily dependent on just four industries: autos, pharmaceuticals, telecommunications, and movies. You don't see many Fixodent or PoliGrip commercials on prime time anymore. A today's CPMs, makers of dental adhesives have every incenti to relentlessly target only the toothless.

The rise of micromarketing is as much a response to th fragmentation of consumer markets as to the fragmentation the mass audience. In the 1950s and 1960s, the country was f more uniform in terms not only of ethnicity—the great Hi panic influx had not yet begun—but also of aspiration. Th governing ideal was not merely to keep up with the Jonese but to be the Joneses—to own the same model of car or disl washer or lawn mover. As levels of affluence rose markedly the 1970s and 1980s, status was redefined. "From th consumer point of view," says McDonald's Light, "we've ha

COMMENTARY

BY ANTHONY BIANCO

Quality news: who will pay the tab?

SURVEYS SHOW THAT A GROWING majority of Americans regard advertising as an annoyance at best. How easy it is to forget that advertising also has served to massively subsidize our consumption of news and entertainment for the better part of a century. With radio and television, the subsidy is complete: Broadcast programs are free for the taking. Newspapers and magazines charge, but circulation income doesn't come close to covering production costs; only advertising has made print financially whole.

The business world's evolution from mass to micromarketing inevitably will shrink advertising's subsidy of media content, to uncertain but potentially dire effect. Whatever happens, Americans are unlikely to suffer from a shortage of entertainment as long as there is a Hollywood. The real issue is the fate of news in the micromarketing era. It boils down to two questions:

Can the mass media make money from digital publications that tap advertisers' desire for targeted ads? And, if the ad revenue from digitalization proves inadequate, will Americans be willing to pay directly for good journalism?

As it is, mass media have been diminishing their investment in newsgathering for years in an attempt to maintain (or in some cases increase) profit margins in the face of audience shrinkage. In network news, the number of correspondents has been cut by a third since the 1980s. In radio, the number of full-time newsroom employees dropped 44% from 1994 through 2001. *Time* magazine's news staff has shrunk by about 15%, and *Newsweek*'s by 50%, over the past 20 years, while the newsweeklies' roster of foreign bureaus has declined by 27% and 31%, respectively, according to the Project for Excellence in Journalism.

Within journalism, angst over the profession's future is acute. "Is there something missing?" asks Orville Schell, dean of the journalism school at the University of California at Berkeley, lamenting the lack of a new business model that will sustain quality journalism. "I don't have the answers, but I do know that things aren't working well."

What is at stake is abundantly clear, even if the solution is not. Although the audience for news is fragmenting along with consumer-products markets, Americans remain heavily dependent on the mass media for national and international news. According to a 2003 survey by the Pew Research Center for the People & the Press, 83% of us get most of our news from television, 42% from newspapers, 19% from radio, 15% from the Internet, and less than 5% from magazines. (The total exceeds 100% because more than one answer was allowed.)

MONEY HUNT

ADVERTISING REVENUE generated by nightly network news shows rose in 2003, the first uptick since 1999. But prime-time network magazine shows are losing airtime and ad sales. What's more, TV execs seem overly enamored of the income-augmenting potential of product placement in reality, sitcom, and drama programming. (News shows are off-limits, at least for now.) Younger viewers don't seem to mind the intrusion, but rampant product placement could turn even more older viewers away from TV without adding enough new income to protect network news divisions from an eventual ad revenue implosion.

For years, newspapers and magazines have been trying to bring in

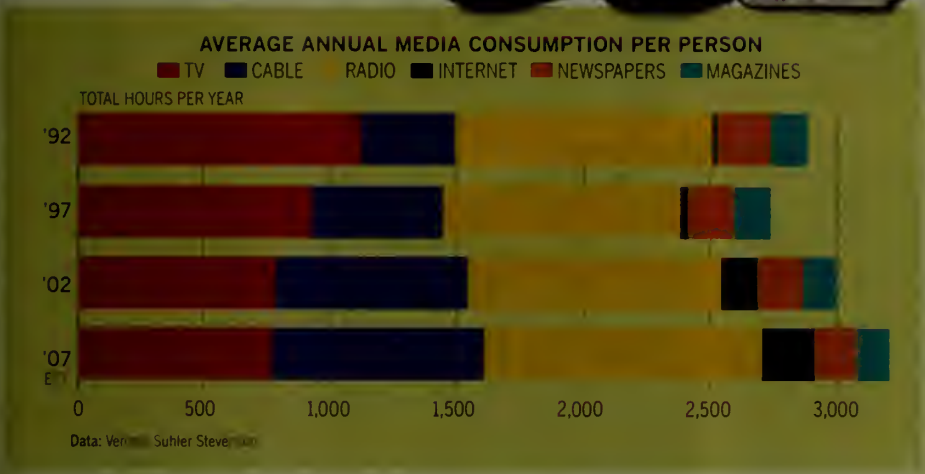
change from 'I want to be normal' to 'I want to be special.'" As companies competed to indulge this yearning, they began elaborate mass production into mass customization. As a alk down any supermarket aisle makes plain, the consumer is vash in choice. TNS Media telligence has 2 million ands in its database and is lding an average of 700 per ıy. In 2003 alone, 26,893 w food and household oducts were introduced, cluding 115 deodorants, 7 breakfast cereals, and)3 women's fragrances, ac- rding to Mintel Interna- ɔnal Group Ltd.'s Global ew Products Database.

For marketers, product oliferation has proved to extra money by sponsoring conferences and selling books and other merchandise. While the additional income can be significant for a niche publisher skilled at licensing, general interest news publications are too big and too short on obvious product tie-ins to find redemption in brand extension. To this point, the pursuit of ancillary revenues has failed utterly to diminish print's dependence on advertising, which accounted for 54% of magazine industry revenues in 2002, up from 52% in 1998.

That leaves circulation revenues, which account for a third of print revenues. While a number of publications have boosted newsstand prices of late, subscription rates have stagnated for years. The consensus view is that rate hikes would be suicidal. "We are conditioned now to think subscriptions are cheap—and Wal-Mart keeps telling us things should be cheaper," says Kelly P. Conlin, CEO of Primedia Inc., which publishes 120 specialty magazines.

America's shifting media mix

Digital media are playing an ever-bigger role



The *Atlantic Monthly* is defying convention to test the willingness of readers to pay up for quality journalism. It slashed its rate base by 28% earlier this year, to 325,000, and is preparing to double its average subscription price, to about $30. Dan Capell, editor of *Capell's Circulation Report*, is cheering on *The Atlantic*. "It will improve the demographic by cutting out all the fly-by-night circulation that wasn't paying for it anyway," Capell says. "Advertisers will respond to that."

WILD, WILD WEB

THEY SHOULD, because *The Atlantic* is making itself more useful to micromarketers without dumbing itself down or narrowing its purview. The magazine's target audience—serious readers—might be a diminishing breed, but they are much better educated and more affluent than the average American. "Where advertisers are going is that they'd rather have a smaller audience with a more committed readership," says David Verklin, CEO of media buyer Carat North America.

The wild card in the outlook for news is the Web. By now, every broadcast station and publication of note has created an online version of itself. There are numerous indigenous news sources as well, but a majority of the most popular Web news sites are owned by one of the 20 biggest media companies. The Internet already is a vital source of news and offers enormous long-term potential for news businesses that can figure out how to exploit the medium's intrinsic advantages—notably broad, low-cost distribution, interactivity, and state-of-the-art digital ad formats.

The mass media's heavy investments in the Web are just starting to produce profits for many leading news sites. Online news is even more ad-dependent than print, because few publishers have dared challenge the free-for-all ethos of the Web by charging for access to their coverage. Online ad sales are growing at a healthy clip but are a long way from sustaining newspapers and magazines at their current size. Consider the New York Times Co., which sold $847 million of print ads and $34 million of Web ads during the first five months of 2004.

Can online news generate sufficient profits to finance a first-class newsgathering operation? Perhaps. Someday. In the meantime, right-sizing à la *The Atlantic* is likely to prove the most effective way for print in particular to adapt to the super-segmenting of America.

–With Tom Lowry in New York

PHOTOGRAPH BY TIM MCGUIRE/CORBIS; CHART BY LAUREL DAUNIS-ALLEN/BW

Technological advances will enable marketers to draw an ever-finer bead on consumers

shot at it and only spend behind them,'" Ephron says. Unilever has applied the principle of brand selectivity on a much grander scale. Not only has it redistributed advertising dollars away from TV to support its most promising product lines with targeted marketing but it also has winnowed its roster of brands to 400 from 1,600.

"PERMISSION MARKETING"

AT THE SAME TIME, MORE AND MORE companies across a wide range of consumer industries are turning to targeting to try to cost-effectively solve the Rubik's cube created by the piling up of product proliferation atop media fragmentation. In addition to altering their media mix, big marketers are moving beyond the usual demographic data to gather personal information about consumers' attitudes, desires, and habits. It's all about "relevance," the micromarketer's mantra.

American shoppers are studied in their homes by teams of cultural anthropologists and are pursued over the telephone and online by survey takers of all sorts. Over the past few years, Grey Worldwide has conducted more than 100,000 interviews and has spent millions of dollars to devise a methodology for identifying the particular emotions that lead people to buy particular products. It might sound like mumbo jumbo, but believers include P&G's Stengel. "The future of marketing will be much more oriented to permission marketing—marketing plans and advertising so relevant that it is welcomed by consumers..." Stengel says. "Grey's work is an important step forward."

Technological advances will continue to enable marketers to draw an ever-finer bead on consumers through a variety of media. Already, many publishers—offline as well as on—are able to distribute content tailored to particular households. The libertarian monthly *Reason* customized its June issue so that each of its 40,000 subscribers received a copy with his or her name and a close-up satellite photo of his neighborhood on the cover. This stunt was meant to call attention to an cle about the increasing capabilities of database managen

The logical-end point of micromarketing is a persona message—and product—for each consumer. However, fev companies are ready to segment markets as fine as this jus They worry about inflaming consumers' privacy concerns their hesitation is mainly a matter of economics. Done r micromarketing is cost-effective, but that doesn't mear cheaper. To the contrary, advertisers typically pay a prem rate to reach a defined audience; the closer the targeting steeper the CPM. The notion of paying up to reach a sm group of people remains dauntingly counterintuitive to b managers weaned on mass marketing. Even at P&G, televi remains the path of least resistance. "What P&G knows r than anything else is TV..." says Mark Schar, a former v president for global business development at the comp "No brand manager at P&G ever got fired for recommendi 30-second TV spot."

Not yet, anyway.

The progress of micromarketing appears to be inexorable vored as it is both by economics and demographics. Cert there is no stopping media proliferation, for it is providing sumers with what they crave: a wealth of new content and i vative modes of consuming it. The mass market will not di pear, nor will the mass media. But the fortunes of man America's best-known companies now will rise or fall depen on how well they adapt to what is shaping up as a long chaotic transition from the fading age of mass marketing t dawning era of micromarketing. ■

–With Tom Lowry in New York, Robert Berner Michael Arndt in Chicago, Ronald Grov Los Angeles, and bureau rep

BusinessWeek online For more on how marketing chiefs at Proct Gamble, McDonald's, and elsewhere are handling the shift away f the mass market, go to www.businessweek.com/magazine/extra.

From mass to micro, how the world has changed

Big marketers can't cast a wide net anymore

	OLD	NEW
CONSUMERS	Couch potatoes passively receive whatever the networks broadcast	Empowered media users control and shape the content, thanks to TiVo, iPod, and the Internet
ASPIRATIONS	To keep up with the crowd	To stand out from the crowd
TV CHOICE	Three networks plus a PBS station, maybe	Hundreds of channels, plus video on demand
MAGAZINES	Age of the big glossies: *Time*, *Life*, *Look*, and *Newsweek*	Age of the special interest: A magazine for every hobby and affinity group
ADS	Everyone hums the Alka-Seltzer jingle	Talking to a group of one: Ads go ever narrower
BRANDS	Rise of the big, ubiquitous brands, from Coca-Cola to Tide	Niche brands, product extension, and mass customization mean lo of new variations

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MITSUBISHI MOTORS
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channeling the future

Marketers are on the hunt for folks like 23-year-old "CJ" Carson. But with an array of digital devices, he's hard to find.

BY STEPHEN BAKER

FINAL EXAMS ARE OVER, AND THE SUN IS SHINING BRIGHTLY IN State College, Pa. Twenty-three-year-old Gordon Carson Jr.—CJ for short—has every reason to kick back on the terrace at the Mad Mex restaurant and drink a beer. He is graduating in a few days with a degree in supply-chain management and is to be commissioned later this summer as a lieutenant in the U.S. Marines. For now, it's time to relax. And for CJ, that means lots of time in front of screens. He loves TV, he chats with friends, and he plays card games on the Internet. He rents video games and exhausts them in a week. He's nuts about movies and is reading the paper-and-ink edition of Robert Ludlum's *The Bourne Supremacy* to prepare for this summer's movie release.

Like much of his generation, known by marketers as "millennials," CJ lives in a world jam-packed with information and entertainment. Born between 1979 and 1994, the 60 million in this generation are coming of age in the new millennium. They practically grew up with the Internet, so they're far more likely to regard information as something they can control. This thinking extends from one device to the next. Through most of his waking hours, CJ wades through three or four streams of data at the same time. Last baseball season, his roommates say, he hooked up three TV sets, each playing a different game, and watched a fourth with streaming video on his laptop—toggling all the while between the game and a fantasy baseball

All these diversions are enough to drive advertisers b Coaxing a generation of consumers who swim in informatic focus on one ad—it's like getting a fish to concentrate on particular patch of water. What's more, while the millen consume gobs of digital fare, they also master tech tool evade marketers and to customize their own programm Commercials on TV? Those that fail as entertainment are passed by flurries of channel surfing, or zapped with the pu a button on the TiVo Inc. remote. Pop-up ads online? They better offer something useful, or they'll be nixed by a po blocker. The frustration among advertisers is such that startup, BrandPort Inc., is building its business on paying lege students 50¢ to watch 30-second ads on their compu "Companies are desperate to grab their attention," says K Varghese, the company's chief executive officer.

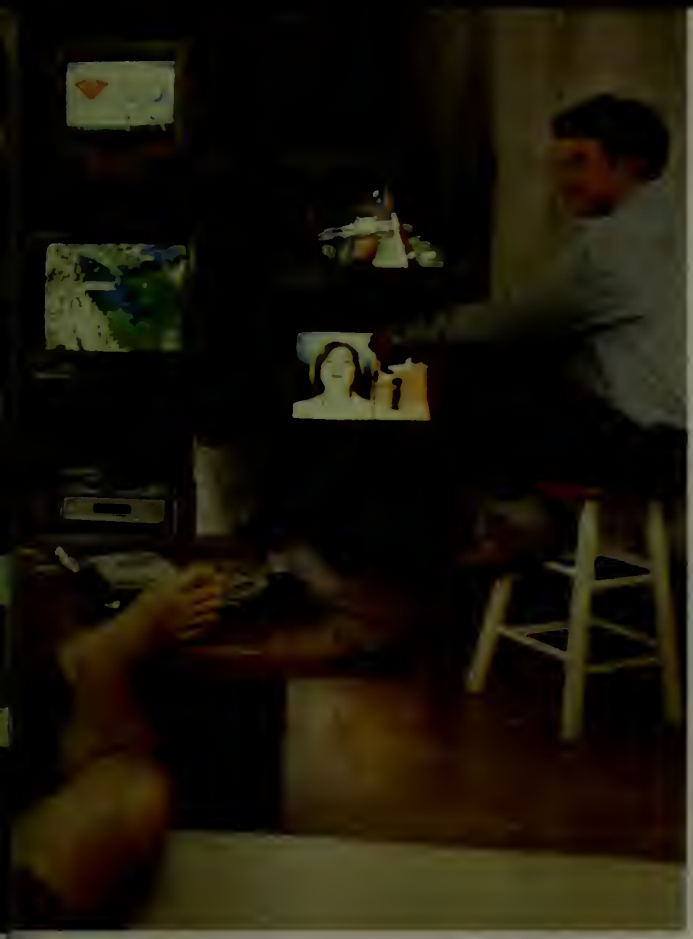
For advertisers, CJ's generation is not only a vital consu market but also a laboratory for the future. College students ing away from home make up the richest concentration of ly adapters, pioneers of a digital lifestyle. Four out of fiv them have broadband connections and cell phones, accor to recent Harris Interactive Inc. survey. And they're far n likely than the rest of the population to play video games,

College: a digital laboratory for marketers

THAT BEEPING IN YOUR POCKET IS A TEXT MESSAGE Some four out of five college students carry cell phones, and not just for talk. A fast-growing 36% of them send and receive short messages from phones, twice the national average. Ads to cell phones are the next frontier for marketers—and it starts on campus.

FAT PIPES While only one-third o homes have broadband, more tha students on campus connect to th through high-speed links. They ne to download music and video. As multimedia ads spread through th college students are among the fi click on them.

Data: Harris Interactive Inc., Alloy Inc., *BusinessWeek*



"LIKE A SPORTS BAR" For CJ (right) and his college roommates, there's no such thing as too many TV and PC screens

line, and send text messages by phone. But how to reach ough the tangle of media and connect with young, tech-vy consumers? "This is the group all advertisers are trying to ," says Malcolm G. Bird, a senior vice-president at America line Inc.

ADGET CENTRAL

ENDING SOME DOWNTIME WITH CJ and his four room-ates in their unkempt State College apartment provides a mpse at how this generation consumes information—and w the media and advertising industries are hurrying to re-ond. The result, it's already becoming clear, is transforming dia and advertising into something that reflects the digital aos of CJ's apartment.

How so? CJ's apartment features a mess of appliances and dgets. But they often work in concert, and many of their func-ns are starting to overlap. The computer is the stereo and an ernate TV. The game console hooks up to the Net. The cell one sends votes for interactive-TV programs, like *Survivor*. is turns TV into something more like the Internet, with the one functioning as a mouse. The traditional barriers between these media hardly exist in CJ's apartment. That means that once visitors take their eyes off the dead fish floating in the clouded aquarium, they can enjoy a privileged view of the coming age of digital convergence.

Lesson One in this world is that the customer, with his finger on the zapper, the mouse, or the remote, wields control as never before. This means that advertisers have to come up with commercials CJ values. Some succeed. But instead of blasting him with fusillades from the TV, they must reach him through hundreds of Web sites, channels, video games, even billboards. "The idea is to surround them," says Matthew C. Diamond, CEO of Alloy Inc., a New York ad agency specializing in the youth market.

The industry brims with theories on what makes millennials tick. They're renowned for multitasking, regarded as hard sells on brands, skeptical about advertising. "We have a tacit arrangement with them," says Martyn Straw, creative director at BBDO New York. "We pretend not to sell, and they pretend not to buy."

CJ, for one, indulges in no such charades. He's an avid consumer of entertainment and gadgets. He can catalog the model numbers and prices he paid for items going back years. Every summer, he says, he spends some of the money he earns on a "big-ticket item." Two years ago, it was a 27-inch JVC TV. Last summer, he brought back a TiVo digital recorder.

Here, CJ is on the early side of a trend. To date, deeper-pocketed boomers have led the trend toward digital recorders while students have waited for hardware and subscription prices to drop. But CJ sees the digital recorder as an essential for time management. He uses it to record a long list of shows, from *CSI: Crime Scene Investigation* and *The Sopranos* to *Jeopardy!* And he says it should come in handy in the Marines. "If you're bivouacking, you can TiVo the whole week's programs," he says. One area where CJ lags: cell phones. He's still waiting to buy one with a color screen, camera, and Internet access.

Movies are his passion, and they influence his life deeply. He's going into the Marines, he says, because he's eager for a life of travel and action; he wants to be a pilot, and he wants to serve his country. But much of his inspiration for the move comes from films he has seen. He cites *Patton* and *Saving Private Ryan*. He still enjoys sitting at home with his father, a regional salesman for PowerBoss industrial cleaners, and "watching *The Bridge on the River Kwai*, [and] old John Wayne and Audie Murphy war movies on AMC."

In the apartment, CJ spices up the mix. Last year he bought a device called a "splitter." This permitted him to channel the cable connection into three TVs at the same time. His ideal scenario is to watch two sports events passively on two of the TVs, with the sound down, and then watch a movie on the third, with the sound up. "It's almost like a sports bar," he says. Not that he just sits there and soaks it all in: He juggles the sound

RY 4 PIZZA? Sure, 99% of students use e-mail. But 59% use messaging, too—and view it as a ker and more spontaneous link to Many keep five or six chat windows a time. Advertisers are pushing nds into the IM windows—and ways to send IM ads.

NO, OVER HERE! More than half of 13-to-24 year-olds watch TV and surf the Net at the same time. Add the phone and video games, and it's hard for advertisers to grab their attention. The trend is to blend promotions through different media. Example? Viewers use AT&T Wireless cell-phone text messages to vote in Fox's *American Idol*.

ZAP! The first generation to grow up clicking mice, college kids are used to controlling the flow and content of programming, whether music downloads or TV. It's a made-for-TiVo generation. Although parents still own more personal videorecorders than kids, PVRs are expected to become a dorm standard over the next two years.

To reach kids, sponsors spend big on product placement and digital billboards in stadiums

on the programs with his universal remote, and he often watches all three out of one eye while playing a card game with his roommates, or surfing on the Net.

CJ's generation is famous for such frenetic multitasking. In previous times, of course, students often listened to the radio, watched TV, and yakked on the phone while doing homework. But today's young people have far more tools, and they use them. It's typical, say marketers, for young people to surf the Web and watch TV at the same time, often looking up to the TV only for funny scenes or replays of a home run or touchdown.

CAPTIVE AUDIENCE A Web ad for *Kill Bill: Vol. 2* got CJ "psyched" for it

How do advertisers respond? For starters, they pump promotions into the programming. Avon Products Inc., for example, not only sponsors the NBC soap opera *Passions* but also has paid to have one of the lead characters work on the show as a sales rep for its youth line of cosmetics, mark. "We needed our business to be woven into the fabric of the show," says Deborah I. Fine, president of the company division, Avon Future. Following the same thinking, advertisers pepper sports programming with a blitz of sponsored spots, with digital billboards even popping up on the hallowed brick walls of Chicago's Wrigley Field.

I WANT IT NOW

YOU MIGHT THINK CJ WOULD USE TiVo to cut the ads out of sporting events. It's a common practice to start watching a game about an hour after it begins and then zap the ads until catching up to real time—preferably on the last play of the game. But this approach collides head-on with a common priority in CJ's generation: the fervor to have up-to-the-second information. "I don't TiVo sports," he says. "It's too real." He figures that if he watched a game even minutes behind everyone else, he would be in the dark while everyone else knew the score—a painful idea. What's more, since he always has the Internet up when the TV is on, he couldn't help but see the up-to-date score. That would short-circuit the drama on the tube. all those commercials? He has plenty of other screens to loo while they're playing.

This common desire among millennials to be in the know to be among the first to experience something, provides m keters with a useful hook. Video rental outlets such as Mil down the street from CJ's, prerelease newly arrived DVD midnight—giving a few customers a chance to see them e This spring, CJ hurried there at midnight to rent *Lost in Tr lation*, a movie was just reach State College thea "I saw the DVD a before everyone did," he says.

Advertisers who fare best in CJ's w have a line on his passions. When they s ceed, the ad becomes part of his world, he passes on the message to friends. He s he's happy, for example, when players fi his favorite baseball team, the Phillies, named on ESPN as Subway Subs of Week—an award named for the sandw chain. And he recalls feeling excited w he visited the Yahoo! community site spring and ads for the Quentin Taran movie *Kill Bill: Vol. 2* popped onto screen. "I loved it," he says. "It got me j ched for the movie."

Miramax Film Corp. lucked upon a The next challenge is to take the luck ou it and pepper consumers like CJ with lo of commercials customized to their tas location, even the time of day. He already sees marke working to pry loose his personal data. "It happens all time," he says. When he visits new sites, forms pop up ask him for personal information. "I say 'bag it,' and c right out."

CJ is suspicious of such entanglements—worried that m keters will use his data to bombard him with ads. He wo rather stay in control, even if it costs money. He has already downloading pirated music, for example. He's scared of vi es and the corrupted files that could come with them. He even started to buy CDs again. "If you go the day they come they sometimes sell them for $9.95," he says. The lesson? along with many of the millennials, will spend money—but mands options and control.

And control over their countless options gives them precedented power. In a sense, this reverses traditional r It's the advertisers, like sweaty-palmed young job applica who are nervously practicing their lines for CJ and 60 mil other demanding millennials. These marketers know they better make a good first impression. Because CJ and his ge ation call the shots. Anyone who bores them will be get blocked, zapped, and tuned out for years to come. ■

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Accenture Hits The Daily Double

First, a fat contract. Then strong numbers that point to a consulting recovery

SEABISCUIT. THAT'S THE name Accenture Ltd. employees gave to their bid to win a contract from the U.S. government to create a new border security system. Although Accenture is one of the world's top high-tech consulting firms, workers felt their odds were just as long as those of the racehorse that upset War Admiral to snare the Pimlico Special in 1938. After all, Accenture had never won a contract near the size of this $10 billion purse. It was up against outfits with closer ties to Uncle Sam. And some politicians were incensed that a company with a Bermuda headquarters, cutting its U. S. tax bill, would land such a plum.

GAINING MOMENTUM

BUT IN MAY, ACCENTURE came from behind and nabbed the prize. Accenture wowed government officials with a demo that included biometric devices that scanned fingerprints and wireless tags that tracked immigrants' whereabouts. James A. Williams, program director for the government contract, called US-VISIT, said the presentation proved Accenture had the vision, management skills, and technology expertise to get the job done.

CEO-TO-BE Green is betting on growth in outsourcing

These days, Accenture is like a horse gaining momentum down the backstretch. On June 17, it announced results for the quarter ended May 31 that beat analysts' expectations. Sales climbed 21%, to $3.69 billion, while net income nearly doubled, to $263 million. For the fiscal year ending Aug. 31, Schwab Soundview Capital Marke pects Accenture's sales to climb 14 $15.3 billion, and net income to rise to $728 million. "We are excited im ing what we can achieve with the w our back," Chief Financial Officer Ha You told investors in a conference ca

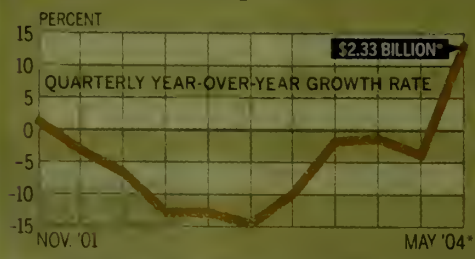
The tailwind bodes well for the consulting industry. Consulting has shrinking since 2001. Kennedy Info tion Inc., of Peterborough, N.H., ha dicted that the market would recove year and grow 4%, to $125 billion there was scant evidence of a rebou til Accenture's results. In the May qu the company's consulting sales rose vs. a 10% decline a year earlier. An say that rising demand should filter to other strong players, inclu IBM and Computer Sciences "Things are definitely looking says Kennedy Vice-Pres Bradford Smith.

Accenture also is bene from a major push into outso ing. The company, No. 9 in *nessWeek*'s latest Inform Technology 100 ranking of t top performers, has staked leading position in the fast-g ing market for so-called bus process outsourcing. It's focu on the two most promising ments, taking over humar source and financial functio companies such as BP PLC.

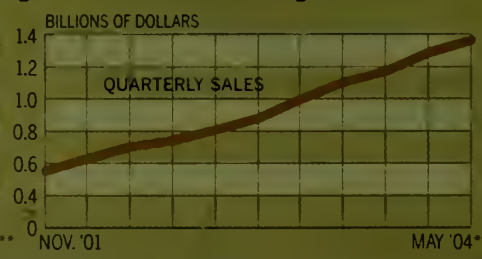
Outsourcing will only be more important as Acce changes its leadership later year. Co-chief Operating O William D. Green, who is exp to take over the reins from cu Chief Executive Joe W. Forehar Sept. 1, says that his goal is to outsourcing to 50% of reve from 32% last year. To get there, Acce is investing $300 million in new hard and facilities and hiring 30,000 new ployees this fiscal year, bringing its to 107,000. "It's a critical part of our st

ACCENTURE RISING

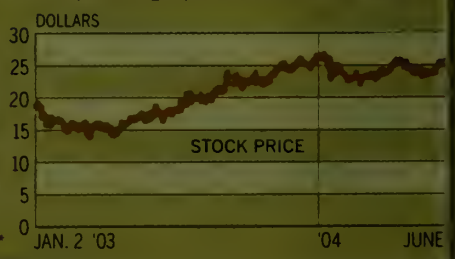
Accenture's consulting business is recovering...



...while outsourcing takes off...



...pushing up the company's stock



Data: Company reports, Schwab Soundview, Yahoo Finance *CONSULTING SALES FOR MAY, '04 QUARTER **PRELIMINARY RESULTS

said Green in an April interview. Still, the initiative is filled with land mines. Outsourcing is a much different business from consulting. While consulting projects are typically short term, outsourcing deals stretch out over many years and require higher up-front investments. Plus, outsourcing contracts are easingly structured on a "gain-sharing" basis in which Accenture gets paid only when it meets specific goals, such as cost-saving targets. One misstep can tunnel profits. "The biggest issue [for Accenture] is the move towards outsourcing," says Dennis A. McGuire, president of TPI, an outsourcing adviser in the Woodlands, Tex. "You are going from helping people solve problems to being over problems."

Beyond outsourcing, Accenture's biggest opportunity—and risk—is the US-VISIT contract. Several politicians remain determined to yank the deal because of Accenture's Bermuda incorporation. "It is outrageous and it is wrong to reward [companies like Accenture] for abandoning our country," says Congresswoman Rosa L. DeLauro, (D.-Conn.), who tried in June to bar Accenture from getting the contract. DeLauro failed, and Accenture seems unlikely to lose the deal unless Democrats wrest control of both the White House and Congress in November. Still, it will be operating under a microscope, and slips could cost it dearly.

Accenture execs pledge that they can manage the risks. They say the political storm over US-VISIT should die down once Accenture demonstrates it can do an effective job. And the company is taking great care to avoid the pitfalls of its outsourcing push. Before it bids on new contracts, at least five people conduct reviews. "Deals go through many, many screens," says You. Accenture will have to clear many high hurdles to keep setting the pace for the tech services industry. ■

–By Spencer E. Ante in New York

IT 100 UPDATE

On July 6, BusinessWeek Online will launch a monthly update of the Information Technology 100, the magazine's ranking of the top technology companies worldwide. The update will track how the stocks of Accenture and other companies in the IT 100 have fared over the previous month. For a look, go to www.businessweek.com/it100/update

COMMENTARY

BY ROBERT D. HOF

Earth to Silicon Valley: You've Lost this Battle

Why tech should end its fight against options expensing

IF ANYONE THOUGHT tech executives might finally give up their long fight against counting employee stock options as an expense, a rally on June 24 quashed that notion. More than 700 employees bused to Palo Alto, Calif., by Cisco Systems, Intel, Sun Microsystems, and other Silicon Valley companies staged a protest near a hearing by the Financial Accounting Standards Board, which wants options expensed by yearend. Jim Cunneen, chief executive of the San Jose Silicon Valley Chamber of Commerce, led a chant: "You are the face of employee stock options!" "Yes we are," they shouted back, cheering to Tom Petty's rock anthem *I Won't Back Down*.

It's too bad the tech industry refuses to read the writing on the wall, because its efforts are almost certainly doomed. True, a bill to block FASB's rule may soon go to the House of Representatives. But even if it passes there, it likely won't get past the Senate. And while FASB on June 29 raised the possibility of delaying expensing for a year because of the difficulty of implementation, it still seems like a sure thing. What's more, a majority of institutional shareholders—the real corporate owners—have spoken. In recent months, they have told Intel Corp., Apple Computer Inc., and others they want options expensed so they can compare companies consistently. Even some tech companies, from Microsoft Corp. to the online DVD rental service Netflix Inc., now support expensing.

Investors are all for expensing, and they should get the last word

An industry that rightly prides itself on creating innovative solutions to problems needs to ditch its shrill, unconvincing arguments and threats. Instead, execs should deal with the new reality at hand. To their credit, some recognize the need to move on. "At this point, it's unrealistic to protect this vehicle," says Eric Hahn, founder and chairman of Proofpoint Inc., an e-mail antispam startup in Cupertino, Calif. "If this is what the market wants, we should do it."

So why do so many people in tech continue to fight? Because options long ago became a religion in Silicon Valley. In the canon of the Church of Everlasting Options, these shares are the holy flame of innovation. Expensing them, goes the gospel, will douse the fire, make outfits look less profitable, and drive away investors. As a result, execs say, they will have to get rid of options for the rank and file, hurting innovation and slowing the economy further. "It could be a real problem for the country," says Rick White, CEO at tech lobbyist TechNet.

The industry's latest argument, in fact, is that expensing options will put U.S. companies at a competitive disadvantage to overseas rivals. China, India, and other countries do not require expensing, so tech leaders such as Cisco Systems Inc.

ON DEFENSE Tech workers protest near a Palo Alto FASB meeting

CEO John T. Chambers contend that the best and brightest techies, many of them immigrants, will stay overseas and work for local companies. "I don't know how to compete with that without broad-based ownership," Chambers told *BusinessWeek* last December.

This, like most of the Valley's arguments, doesn't hold up. Many Indian and Chinese companies trade on U.S. stock markets, so they'll be obligated to expense options just like American companies. Besides, accounting's purpose is to protect investors, not to set industrial policy. Moreover, the most innovative U.S. companies —small, private startups that account for most job growth—wouldn't be bound by expensing rules because they don't report earnings. So expensing actually would give them the very advantage over large, publicly held rivals that expensing's opponents claim they would lose. That's why Vinod Khosla, a general partner at venture-capital firm Kleiner Perkins Caufield & Byers, backs expensing.

In the end, there's no logical justification for the current situation: Options, which clearly have value to employees, are left off the income statement while companies then take a tax break for the phantom expenses. If that isn't bad enough, firms routinely buy back stock to avoid dilution of share prices when employees exercise the options. But because such buybacks aren't counted as operating expenses, they don't show up as the real cash-flow drain that they are. It's no wonder that Reed Hastings, chief executive of Netflix, which voluntarily expenses options, calls the current setup "the immaculate compensation."

The industry is right about one thing: It's really tough to come up with a clear value for options. FASB's recommended formula, called the binomial lattice method, may well overvalue some options. It could even potentially allow execs to n nipulate earnings by changing assum tions about stock movements and the ti ing of options exercises. "The bigg question is how to value stock option says eBay Inc. CEO Margaret C. Whitm whose shareholders on June 24 vo down a proposal to expense options.

But there are promising approach Sean Scrol, leader of the options practic actuary services firm Chicago Consul Actuaries, says it's no tougher for tech co panies to make credible estimates of tions exercises or stock volatility than for insurance firms to gauge life expect cies. Options assumptions may need to adjusted over time as firms gain exp ence, he adds, but that's right up tech's ley: Startups always go for it, change di tion as they learn, and ultimately the b solution prevails. Says Scrol: "Once peo get over the hurdle of whether options be expensed, they're going to look at oth kinds of stock options."

Option Alternatives

INDEED, INSTEAD OF following throu on distasteful threats to eliminate optio for rank and file, companies should lo at expensing as an opportunity. Toda rules perversely encourage companies avoid tying grants to how good a job employee is doing because performan based options already must be expens If all options will have to be expens anyway, companies might as well se the chance to tie them to specific p formance goals. That way, options co be transformed from a lottery ticket int steadier, more targeted motivator.

At the least, employers should consi er other forms of equity compensatio Microsoft, Amazon.com Inc., and oth have moved to restricted shares, whi vest over several years. They also must expensed, but, unlike options, they ways have some value. In contrast, wh the company's stock price falls below option's strike price, the options a worthless, and their motivational pow vanishes. Because employees sensit value restricted shares more highly, co panies can give out far fewer—in Am zon's case, less than one-third as many options. So although restricted stock likely a similar motivator, the earnin impact is far less.

Let's face it: The war is over. It's time the tech industry to quit wasting tin money, and energy, and get back to wha does best: Inventing the next big thin that will produce real wealth for us all.

–With Jim Kerstetter in Palo Alto, Ca

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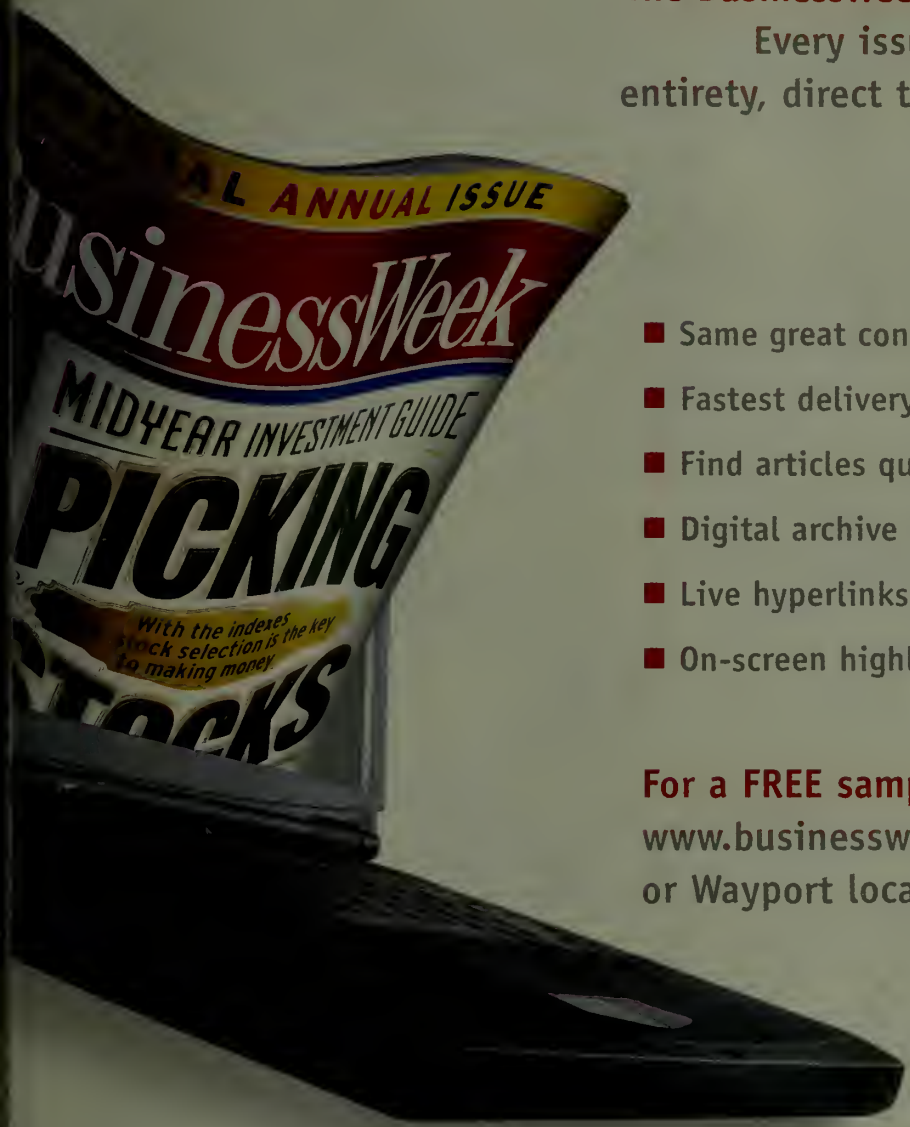

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magine Sony On Steroids

oward Stringer is shopping for movies d music. But will content sell gizmos?

T HAS BEEN A LONG WAIT FOR Sony Corp. For the past two years, the Japanese electronics giant has been gearing up for the second installment of its *Spider-Man* franchise, the web-slinging superstar that grossed a cool $403 million at ox office when Tobey Maguire last into theaters in his red leotard. Since , though, Sony has been a decidedly swinging outfit. Sinking sales of its personal digital devices, and video rders zapped earnings last year, which y 23.4%, to $851 million, for the fiscal ended on Mar. 31. Film sales, mean-e, fell 40%, to $320 million, off its *Spi-Man*-charged year, and music rev-s struggled in the face of piracy and dling market share. So any signs of a eback are welcome at Sony these days, ther they shoot webs or not.

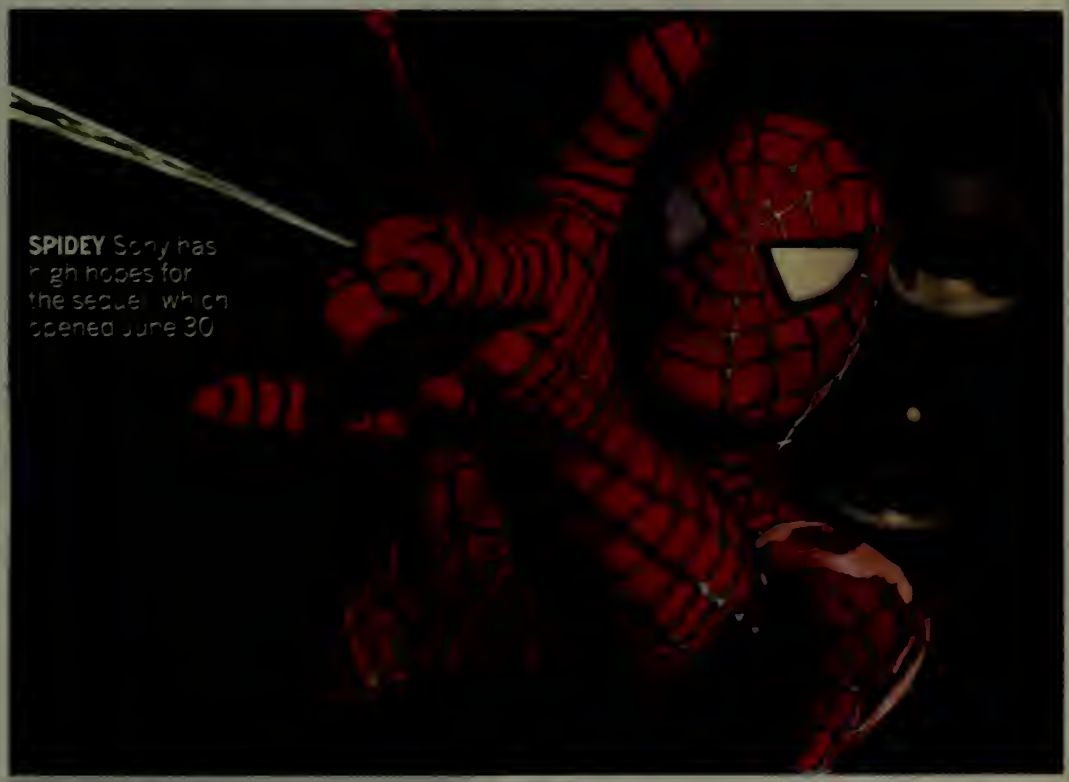
he leading man in the Sony revival is Sir Howard Stringer, a rumpled ear-old Welsh-born executive who is own mission: to turn Sony's peren-y underperforming entertainment into an engine for growth, not just an thought for a company built on elec-ic gizmos. And in recent months, Sir ard has been moving faster than Spi-Man through Times Square.

ringer has placed his biggest bet—$5 n—in a bid to buy Kirk Kerkorian's ro-Goldwyn-Mayer Inc. studio. That ld give Sony Hollywood's largest col-on of older movies just as new tech-gies for offering flicks on demand, the Internet, and on DVD are taking That follows a November, 2003, deal engineered to merge his struggling ic company with rival Bertelsmann's unit. If approved by European and regulators, as expected this year, the ger will give the combined company of the market while slicing an estimated $250 million from overhead. "For a while some of us weren't sure what Howard did at Sony," jokes former Viacom President Frank Biondi. "Now we see that he's remaking the entire operation."

And just in time. Stringer, Sony's vice-chairman, is under pressure from Sony CEO Nobuyuki Idei to cut costs by 10%, part of an overall corporate mandate to reduce overhead companywide. At the same time, headquarters expects Stringer to help finally make good on the long-held—but rarely accomplished—goal of using Sony's movies, TV shows, and music to fuel sales of new consumer-electronic formats. Sony executives would not comment for this story.

For now, Stringer has focused heavily on cost-cutting. Last year, he forced out spendthrift music chief Thomas D. Mottola and installed former NBC President Andrew Lack, a deputy from Stringer's days as head of CBS. Lack slashed more than 1,000 jobs, cutting $100 million. At Sony's film studio, Stringer ordered more than 500 layoffs and has told film executives to rein in profit-participation that was among the richest in the industry. To add muscle, he brought in Michael Lynton, a turnaround expert who shrank costs at Time Warner Inc.'s international AOL operation. Lynton has been ordered to find more places to cut as he streamlines the often chaotic moviemaking process.

So far, so good. But it's always easier to cut than create. While Sony has been profitable in 9 of 11 quarters, Stringer



SPIDEY Sony has high hopes for the sequel, which opened June 30

Stringer's Plan

Spider-Man 2 may not be the only summer sizzler for Sony. Two pending deals could give it a much-needed competitive lift:

Acquiring **MGM** could add a library of more than 4,000 films that generate $450 million in cash a year and may persuade other studios to use Sony's Blu-Ray high-definition format for DVDs.

Merging Sony's music division with **BMG** could yield $250 million in savings and add lots of songs for Sony's Connect, a music-download service.

Data *BusinessWeek*

wants to stabilize earnings by grabbing MGM, which has a more than 4,000-film library that generates $450 million in cash flow from sales of DVDs and to cable TV. But MGM is still a long shot, in part because he had to jury-rig a financing scheme to reduce the parent company's involvement, bringing in two private equity firms and bidding mostly with debt. MGM now says it is looking at alternatives, which could lead to rich new bids from NBC or Time Warner, both of which are itching to get their hands on the studio.

ANOTHER FORMAT FIGHT

IF IT DOES WIN MGM, Sony intends to combine those films with the 3,500 it currently owns to help push a next-generation DVD technology, called Blu-Ray, that offers films in high-definition. Sony needs the added muscle of a large collection of films to help win over Hollywood, which is holding back, waiting for a competing high-definition DVD pushed by Sony's nemesis Toshiba, with help from Warner Bros. and possibly Microsoft. To promote its own format, Sony intends to start shipping versions of its movies on DVD and Blu-Ray in 2005, according to industry insiders. Sony "knows that getting a library is key to the Next Thing—in this case video-on-demand or the Internet," says DVD pioneer and industry consultant Warren Lieberfarb.

Buying MGM would be a coup for Stringer

In the meantime, Sony is rolling out entertainment on the Internet through Movielink, an online service it pioneered that is now being operated by five major studios. As for the music business, Sony is hustling to catch up with the likes of Apple Computer Inc.'s iTunes. This spring, it launched a new online music service called Connect, which has deals with McDonald's Corp. and United Airlines Inc. to offer coupons for songs. It's all part of Stringer's attempt to push the Japanese giant into a fast-consolidating entertainment world before it's too late.

–By Ronald Grover in Los Angeles and Tom Lowry in New York

Blocking the Exits At CSFB

Can new CEO Brady Dougan stop talen from following John Mack out the door

LEGENDARY WALL STREET dealmaker John J. Mack was greeted as a savior when he became chief executive of troubled Credit Suisse First Boston in 2001. But by this summer, the Credit Suisse Group co-CEO was treated as little more than a thorn in the side of the top brass in Zurich. Mack was abruptly ousted on June 24, after months of fighting over whether the firm should pursue a merger with another European bank. Instead, the group decided to go it alone without him. Oswald J. Grübel, 60, became sole CEO, and 14-year CSFB veteran Brady W. Dougan, 44, took charge of the investment bank.

Problem solved? Not yet. Indeed, CSFB's troubles may be just starting. Mack replaced most of the firm's top managers with his own loyalists hired from outside when he took control. And as rainmaker-in-chief, he quickly filled CSFB's coffers with fees from top-drawer clients such as Kohlberg Kravis Roberts & Co.'s founding partner Henry R. Kravis. He rapidly turned 2002's $1 billion loss into a hefty $834 million profit last year.

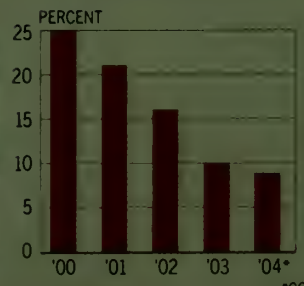
Now, both CSFB's clients and ployees are under siege. As soo news of Mack's departure broke, r began to woo the firm's top talent a steal away its clients—both critic any investment bank's survival. can get almost anyone at CSFB to i view these days," says a banker a other Wall Street firm. "It's 'let's m deal' over there." Chief Administr Officer Thomas Nides, Mack's r hand man, may be the first to go cording to a banker close to him. N declined to comment.

Dougan is under immense pre from inside the firm as well. Ma charismatic leader with strong views a flair for motivating people, is a har to follow. By contrast, Dougan is a d oriented, numbers guy who has through the ranks and spent most o career in CSFB's trading operat Along the way to becoming co-presi of CSFB and a member of the group ecutive board in 2003, he gained trust of key Swiss managers. As he equities in the late 1990s, Dougan ported directly to Grübel, then chi CSFB's securities division, for two y

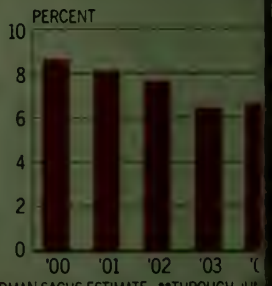
INCOMPLETE TURNAROUND

Though CSFB's profits have rebounded...

...it has lost market share in mergers worldwide...

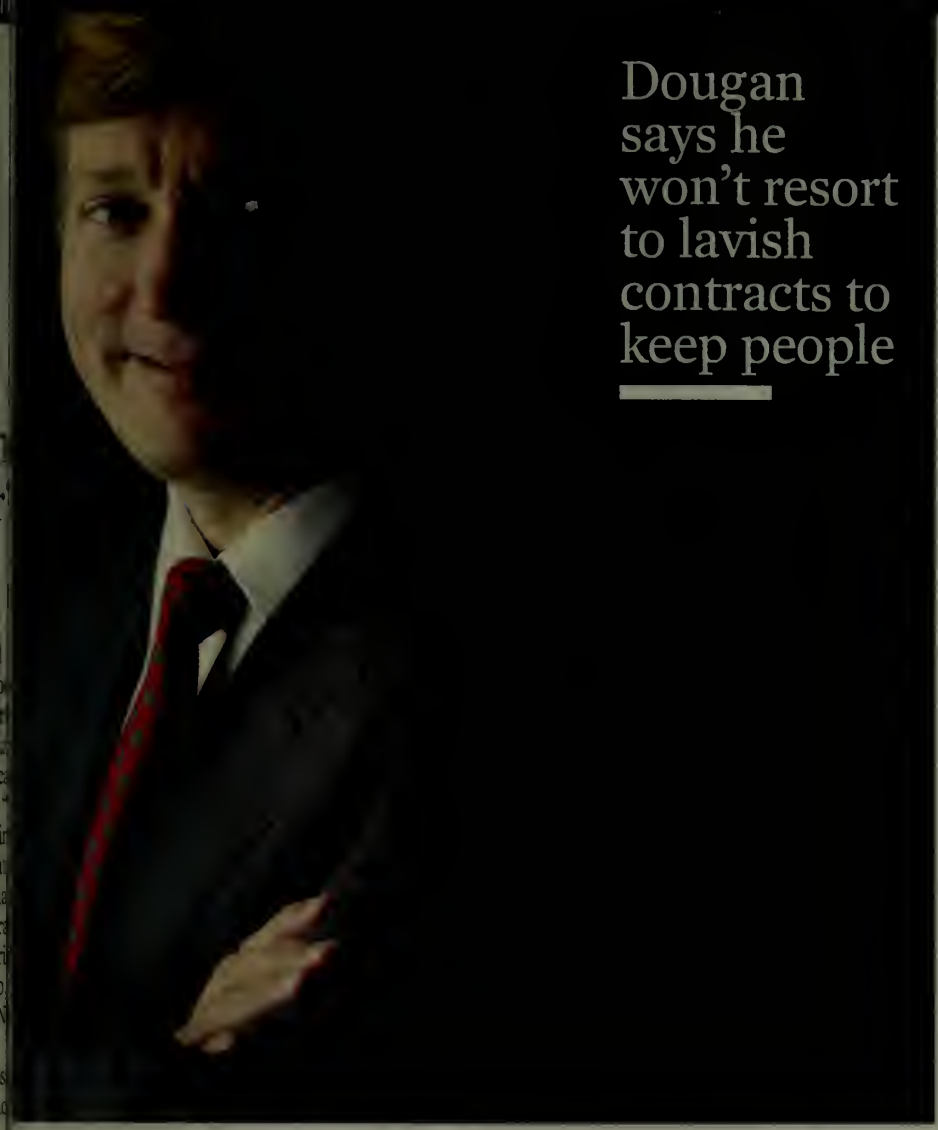


...and slipped in issuir global debt and equi



Data: Thomson Financial Corp., CSFB

*GOLDMAN SACHS ESTIMATE **THROUGH JU



Dougan says he won't resort to lavish contracts to keep people

ll the same, Dougan will have far less rating freedom than Mack ever did. once again reports to Zurich-based bel, who'll be looking over his shoul- "I will spend more time in the U.S.," bel told *BusinessWeek*. And when he's , Grübel says, he'll be paying more at- ion to CSFB's employees and clients, m Mack mainly handled. He aims to d CSFB more deeply into the group.

D HABIT

BEL HAS ALSO SET a high perform- bar. "We need to get [CSFB] back to re we can produce constant profits are not different from our peers," bel says. In fact, he's even taking aim all Street's most prestigious banks, as Morgan Stanley and Goldman, hs & Co. To earn as much as they do, gan's CSFB would have to double rofits.

ougan might have to execute this tall r under adverse conditions. Dougan he wants to make changes at the k. But if he rocks the boat too much, ould provoke an exodus. When Mack hauled CSFB, employees stayed in part because other firms were also cutting costs. But now rivals, their painful overhauls behind them, are hiring again.

The stakes are high for Dougan personally, too. CSFB has a bad habit of running through CEOs. Dougan is the sixth in 15 years, giving him an expected tenure of just 2½ years. He will need all the help he can get to beat those odds.

And that means keeping the talent on board. Dougan is scrambling to convince CSFB staff to stand by him. He has told thousands of employees in town hall meetings, one-on-one chats, and conference calls that CSFB has a bright future and Zurich's support. He also says the firm won't be pursuing any mergers and will be paying people competitively. In one internal call, he went so far as to tell bankers that he wants CSFB to be the "best-paying firm" on the Street after it doubles its profits in the next two years.

The success of Dougan's sales pitch is crucial to CSFB's future. There is speculation that many CSFB top managers are considering leaving, which will make it difficult to run the firm and handle clients. With Mack gone, Dougan is more dependent than ever on the connections that Mack recruits such as Chairman Stephen R. Volk and Co-President Brian Finn brought. And the firm could lose a lot of momentum should Bennett J. Goodman, whom Mack made chief of a new division combining hedge fund and private-equity businesses, walk out. "Our hope is that the majority of the group will stay in place," Dougan says. Through a spokesperson Volk, Finn, and Goodman declined to comment.

FADING FORTUNES

DOUGAN FACES ANOTHER big challenge: Fixing the investment banking business. Although CSFB's tech bankers recently landed Google Inc.'s coveted $2.7 billion initial public offering, the firm has been losing market share since Mack dismantled the empire of former tech banking czar Frank Quattrone, who was found guilty in May on three charges that he interfered with a federal investigation into the tech group. Quattrone plans to appeal.

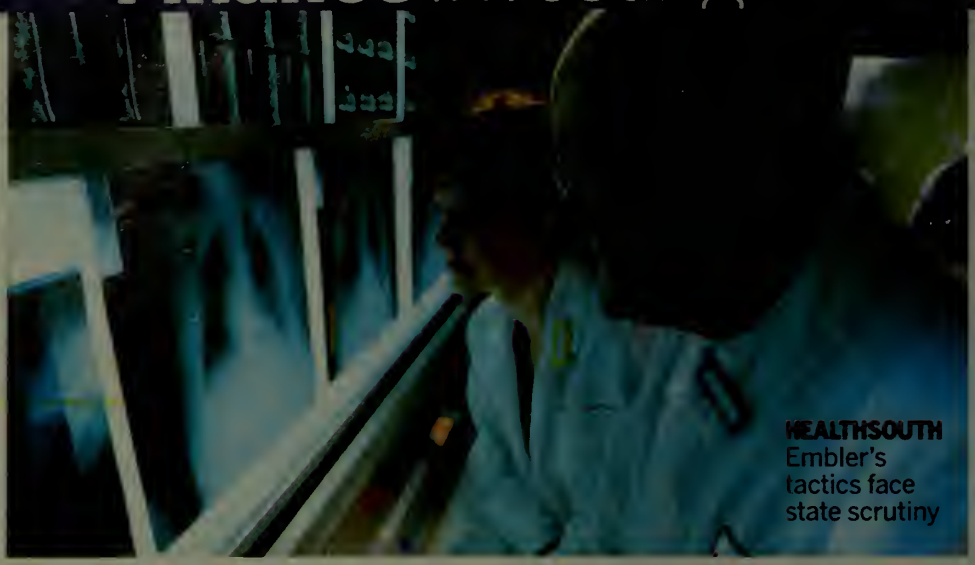
Just before Mack's departure, talk flew inside the firm that the investment banking division was about to be restructured. According to the scuttlebutt, the fortunes of Adebayo O. Ogunlesi, Mack's handpicked head of investment banking, were fading, and he was in danger of being moved. Ogunlesi declined to comment.

Dougan desperately needs to figure out how to motivate his bankers. Many were demoralized earlier this year when Mack gave 50 bankers in the tech group and Los Angeles office one-time stock awards to keep them from bolting. Others felt Mack went back on his word that CSFB would no longer dole out lucrative multiyear contracts to attract and keep top talent. CSFB says the awards of stock, which vest over three years, are very different from the multiyear promises of guaranteed salary and bonuses doled out by Mack's predecessor, Allen D. Wheat.

Both Dougan and Grübel say they will not try to keep people by paying them lavish multiyear contracts. If they did, such special deals could drive the firm back into the red. Instead, Dougan wants to convince people to stay because the firm's prospects are bright and he plans to make it a meritocracy. "We're going to have a fair playing field," he says.

That's just what Mack said when he took over. Now, he knows that not all is fair in love and war—or on Wall Street. Even if you improve your employer's earnings by $1.8 billion, it seems you can't expect to keep your CEO job longer than your luckless predecessors. ■

–By Emily Thornton in New York



HEALTHSOUTH Embler's tactics face state scrutiny

Swooping Down To Snatch a Fortune

Michael Embler squeezed a windfall out of ailing HealthSouth. Did he go too far?

HOW FAR IS MICHAEL J. Embler willing to go in the high-stakes game of vulture investing? Co-managing $32 billion in assets, the 40-year-old senior vice-president at Franklin Mutual Advisers LLC has made millions by buying the cheap debt of beleaguered companies such as MCI Inc. He usually invests as trouble breaks, bets a company will recover, then bags a big profit. Often, Embler has to put a company's management in a financial headlock, banging tables and threatening defaults to ensure that he gets paid. Still, most of his investments in stumbling companies have caused little controversy.

Until now. In March, Embler and a group of bondholders demanded a big payment from HealthSouth Corp., the scandal-plagued Birmingham (Ala.) hospital chain. The rehab specialist quickly fired back, charging in a lawsuit that the bondholders were engaged in a "bad-faith attempt...to enrich themselves unjustly." Embler & Co. argued that HealthSouth had violated its bond covenants, so they were entitled to accelerated payments on a big chunk of their bonds. "The company was unable to meet its contractual agreement with bondholders, and unfortunately the issue involved litigation," says Embler. The two sides settled on June 8; the bondholders won a $41 million payday, of which his firm gets $13 million.

Now the Alabama Securities Commission is looking into allegations made by shareholders that Embler's tactics were improper. Embler declines to comment.

HealthSouth is a typical Embler target. It's digging out from Securities & Exchange Commission and Justice I charges that it fraudulently inflated e ings by at least $2.5 billion from 199 2002. It's unable to file financial s ments until next year, pending a com review of its books, putting it in tech default on its bond covenants.

Embler had invested in var HealthSouth bonds in the past. Bu January he decided to focus on one of bonds—those due in 2012 wi 7.625% coupon. He poured at least $ million into them by the end of Febr on top of the $75 million worth he alr owned. A group of bondholders he bought millions more. That gave ther more than 25% of the issue, the thres at which they could have the com declared in default. On Mar. 11, Em threatened to demand more than $ million in accelerated payments, per ted under the bond covenants becau nancial statements hadn't been filed.

Plan of Attack

Embler's game plan against HealthSouth was simple, severe, and profitable:

1. Buy up at least 25% of one of its bond issues
2. Threaten to put it in default for missing filing deadlines
3. Demand that it make accelerated bond payments
4. Settle with the company and enjoy a $13 million payday

"RUSSIAN ROULETTE"

THE HARDBALL TACTICS provoke equally tough response. HealthSouth turning around smartly, generating $ million in cash over the past year, a had made all of its interest and prin payments on time since August. W more, Embler knew about the technica fault when he invested, according to documents, and therefore, the compan gued, he shouldn't get any special pay So later the same day Embler made hi mand, the company went to Alabama court for a restraining order against calling his actions a "dangerous gam Russian roulette" because his group c force the company into bankruptcy.

Saying they smelled a shaked shareholders, who are usually wiped o a bankruptcy, also jumped to He South's defense. They contacted the and the Alabama Attorney General complained to the board of Franklin's ent, Franklin Resources Inc. in San M Calif., about Embler's demands. Fra declines to comment on the case.

But bond covenants are rather clea addition to the settlement, Embler his group keep all of their bonds and tinue to receive their regular interest ments. The bondholders did agree n push for default now or in the future

Each side says the battle was a tou but fair—bid to maximize returns f shareholders. "It was all about mo says new HealthSouth Chief Executiv Grinney. For Embler, bagging the m may require tough-guy tactics, but t just how he plays the vulture game.

–By Brian Grow in Atl

urning Kmart nto a Cash Cow

Sears deal shows how it can serve as ldie Lampert's investment vehicle

COULD KMART, the discount retailer once left for dead, become investor Edward S. Lampert's shire Hathaway Inc.? The ibility that it will turn into investment vehicle like en Buffett's is looking ingly likely after a June 30 uncement that Kmart ling Corp. will sell 54 es to Sears, Roebuck & Co. e sale, which Troy h.)-based Kmart said d reap up to $621 million, dd to the $2.2 billion cash d the retailer has built up it emerged from bankcy last year under Lams leadership. In Securities & ange Commission filings, rt said it could use its cash quire securities or unrelatusinesses—just as Buffett with Berkshire. Sears, nwhile, will use some rt locations to jump-start new Sears Grand stores, h aren't located in malls. Sears is tryo stanch drooping sales, though many rts are skeptical of the strategy because erce competition from rivals such as Buy, Lowe's, and Home Depot.

e transaction is an artful move by pert, a low-key billionaire who once ed for former Treasury Secretary rt S. Rubin while he was still at Gold- Sachs & Co. His private investment , Greenwich (Conn.)-based ESL Inments Inc., has a stake in both sides of deal: It's the largest shareholder in retailers. The sale shifts a bundle of cash to Kmart, where Lampert thinks he can make better use of it. He bought heavily into Sears when its huge credit-card operations ran into trouble with bad debts and its stock tanked in late 2002. He now holds a 13.5% stake, but doesn't have a seat on the board. Under pressure from Lampert, Sears ultimately sold the credit business to Citigroup for $3 billion.

Lampert swooped on Kmart when the nation's third-largest discounter filed for Chapter 11 protection in January, 2002, buying up the majority of its debt at a big discount from creditors. He changed management, closed 599 of Kmart's 2,100 stores, and hustled the retailer out of Chapter 11 early, in May last year. He also emerged as Kmart's chairman and owner of 51.4% of its new stock, issued to replace most of the company's debt.

Lampert's Lineup

Eddie Lampert's ESL fund follows Warren Buffett's philosophy of holding strategic stakes in a few companies:

KMART Discount retailer	**51.4%**
AUTONATION Auto dealerships	**28.1**
AUTOZONE Auto-parts retailer	**22.0**
SEARS ROEBUCK Department stores	**13.5**
DELUXE Check printing	**11.7**

Data ESL Investments Inc.

ERODING SALES

KMART'S EARNINGS have rebounded since Lampert imposed tighter management and cleaned most of the debt off the balance sheet. In the first quarter through April 28, net profits totaled $93 million, vs. a $862 million loss the previous year. Kmart's new stock, now around $72 a share, has quintupled from its first-day close of $13.55. Still, Kmart's sales at stores open at least a year continue to erode, leading analysts to question its chances of long-term survival against Wal-Mart Stores Inc. and Target Corp.

Some observers contend that Lampert doesn't have to turn Kmart's existing business into a winner to make his investment a success. Just look at Buffett, who acquired Berkshire in the 1960s. Although the textile maker was under siege from foreign competition, Buffett used its cash to make investments with higher returns in unrelated businesses. Bruce Van Kooten, a portfolio manager at Wells Fargo & Co., sees the potential for a similar play with Kmart. "What [Lampert] ended up with [at Kmart] is a lot of cash flow for a minimal amount of money," he says.

Lampert, who declined to comment for this article, is a longtime student and admirer of Buffett, former colleagues say. Like him, he has taken concentrated, longer-term positions in a handful of companies. But with Kmart, he has another advantage: It's sitting on $3.8 billion worth of tax losses that could be used to shield income from future acquisitions. Such buys, says UBS analyst Gary Balter, could become "new cash flow vehicles as Kmart's prospects dim."

With all the cash he now controls—up to an additional $365 million is coming from an earlier sale of Kmart stores to Home Depot—Lampert has plenty of options. Now, like his hero Buffett, he has to find something worth investing in. ■

–By Robert Berner in Chicago

IMG: Show Me The Bottom Line

The razzle-dazzle style of founder Mark McCormack is gone, but profits are better

TIGER An industry unto himself, under IMG

HE WAS HAILED AS A genius and a visionary who practically invented the field of sports marketing. And he was a master schmoozer to boot. So when International Management Group founder Mark H. McCormack died just over a year ago at the age of 72, there was a torrent of speculation over the future of what Wharton School professor Kenneth L. Shropshire calls "the world's most powerful sports-marketing brand."

Under the charismatic McCormack, IMG became the undisputed heavyweight champion of representation, the show-me-the-money guys for sports megastars such as Tiger Woods and Peyton Manning and supermodels such as Tyra Banks. It represents about half of the world's top 20 golfers and is a dominant presence in sports such as tennis, baseball, and football. Says Arnold Palmer, whose legendary handshake with college golf rival McCormack launched the firm in 1960: "They have the right connections and the people, and they produce results." IMG's TWI unit is the world's largest independent producer and distributor of sports programming, handling such disparate offerings as Wimbledon and the World's Strongest Man competition. And its reach extends from owning sports stadiums to running IMG Models, the world's largest modeling agency.

But McCormack, who went into a four-month coma after cardiac arrest early in 2003, hardly left a house in order. Cleveland-based IMG was stretched and struggling under debt that some put as high as $200 million. It had to cope with such boneheaded and potentially conflict-of-interest-laden moves as buying a soccer team in France while at the same time representing athletes and running tournaments (worse, it was a failing team). Making money off classical musicians and theatrical events was also proving to be a Herculean task. Then there were forces beyond IMG's control, such a advertising drought in the last recess the bankruptcy of a key sponsor, lukewarm U.S. interest in sports suc tennis, which is one of its largest busi units. No wonder many were quic predict that McCormack's death woul another devastating blow to the busin

Instead, IMG over the past year has en steps to clean up the mess. "Not apocalyptic happened except that M died," argues Robert D. Kain, who shares the chief executive title with fe IMG veteran Alastair J. Johnston. The who made their marks as agents in tennis and golf sides of the business. spectively, say they have had none of conflicts that often undermine sh leadership. "We have been surprise how easy it is to have a single min things," notes the Glasgow-born Johns And that single mind is aimed at ma money. Sales and billings are dow about $1 billion, from roughly $1.3 bil but profits are up. They have consolid business units, closed money-losing l tions, and laid off 400 people in the year to bring the staff to roughly 2,20

Was that a painful move in the o clubby and ego-driven world of sp marketing? You bet. But the new bo

What's **Hot** at IMG...

PROFITS Fewer business units, more bottom-line focus vs. the heady expansion under founder McCormack.

INVESTORS Looking for outside equity to reduce family stake and fund expansion. May go public in a few years.

INDIA Announced plans to open a sports academy, school, and resort in Hyderabad in 2006. IMG puts up no cash.

MODELING Forget rumors that this part of the biz is for sale. Victoria's Secret girls are as bankable as big sports stars.

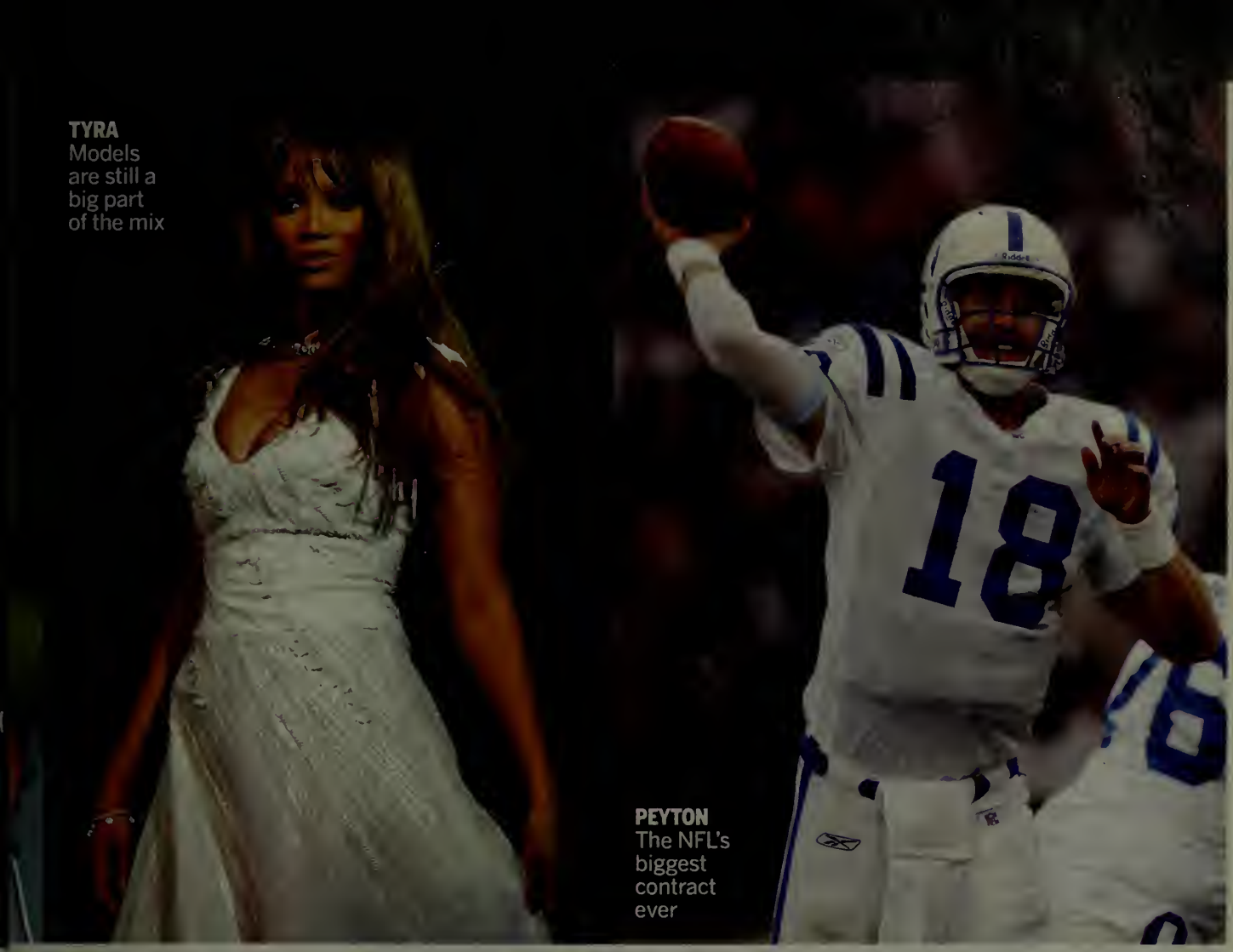
...And What's **Not**

TEAM OWNERSHIP Recently dumped French soccer team because of losses. Critics also cite conflicts of interest.

PERFORMING ARTS Sold off theatrical shows and most of IMG Artists. So long, Itzhak Perlman.

MIDLEVEL TENNIS Dumped some tourneys at a profit. Fan interest is also waning.

STAFFING Slimmed down and is adding personnel only in areas where it makes buckets of money.



TYRA
Models are still a big part of the mix

PEYTON
The NFL's biggest contract ever

more obsessed with bottom-line re-
ts than go-go growth. They have to be.
G, with the help of Roger Kimmel,
e-chairman of investment banker
hschild North America, is talking to
ential investors about buying out part
the McCormack family's stake to be-
ne a minority partner in the business.
eeds to show cash flow and fatter mar-
s. While the founder's family isn't talk-
, it's clear widow Betsy Nagelsen Mc-
rmack, 47, doesn't aspire to run the
npany or sit on a huge chunk of equity
en she could have the cash. Less clear
vhether McCormack's three adult chil-
n, who are in the business, want out.

E MAIN ATTRACTION

E THING IS CERTAIN: The firm's key
yers want in. Insiders say both sides
ee an outside investor is needed, and
y dismiss talk of tension. Johnston ex-
ins elliptically that "participation by
y of equity was not in Mark's business
del." McCormack didn't let his em-
yees in on the equity action because
didn't have to. He was the main at-
ction and the center of all loyalty. He
s the guru who told the world *What
ey Don't Teach You at Harvard Business
hool* in his 1984 best-seller. And he was the manager who nurtured his top agents as if they were stars themselves.

McCormack understood that sports management is a business of personal relationships. Peyton Manning, Indianapolis Colts quarterback and co-winner of the National Football League's Most Valuable Player award for 2003, says that if the high-powered trio who work with him were to leave IMG, "it would be awfully difficult for me to stay." Now, says Randy Vataha of Game Plan LLC, an investment firm specializing in sports properties, "the concern at IMG is how to keep all the human assets as an ongoing part of the business."

One way to do that, of course, is to provide sweeter financial rewards. But insiders don't want to mimic rivals like Interpublic Group's Octagon Worldwide, becoming part of a bigger beast that they fear would curb their style or call the shots. Some options include finding a partner that is already public, or one that can put up the capital to buy out some of the family's stake and, as earnings grow, shift more equity to executives.

IMG still represents about half of the world's top 20 golfers

Kain doesn't even rule out a public offering far down the road, but says "that's something we wouldn't consider for three [to] five years."

In the meantime, the folks who helped inspire the industry's hustling *Jerry Maguire* image are suddenly sounding more like accountants than sports agents. Terms such as "measured growth" and "profit incentives" are dropped casually into conversation. Even the company's agreement to let an outside investor establish a clone of IMG Academies, the famed Bradenton (Fla.) training facility, in Hyderabad, India, is being cast as a fiscally prudent licensing deal rather than a bold new venture. "We wouldn't take on that kind of risk exposure," says one insider.

The initial $135 million instead will be amassed by Fort Lee (N.J.) hedge-fund manager Andrew Krieger, who has had four of his six kids study tennis at the Florida facility. Krieger, a soft-spoken former Sanskrit scholar who heads NorthBridge Capital Management, happens to be both rich and enthusiastic about IMG. But tennis coach Nick

Bollettieri, the founder of IMG's Florida tennis facility, jokingly calls Krieger a "weirdo" and won't commit to even visiting the Hyderabad operation. "I will make up my mind if I go to India," he growls. Even so, Krieger calls the deal a strategic partnership. In return for lending its name, training model, and some staff, IMG gets a fee plus an undisclosed share of the profits in the complex, due to open in September, 2006.

Luckily, the draw of the IMG brand may be all Krieger needs. Despite the challenges of surviving through a long marketing downturn and the loss of its founder, IMG's core has remained remarkably strong. With the exception of tennis powerhouse Serena Williams, whose entertainment aspirations may have prompted her to switch some business to the William Morris Agency in March, the talent has largely stayed in place. Golfer Jack Nicklaus, who left the fold in 1971, even came back shortly before McCormack's death.

More important, the new management has reined in some of McCormack's pet projects. "[Mark] kept score on the size and influence of IMG," notes Johnston. "Because he was the owner, he could wander into businesses that didn't make financial sense." Instead of 20 business units there are now nine, the heads of which were all summoned to Scotland's Gleneagles hotel in February with other senior executives to go over every inch of the IMG operation. Besides the staff cuts, a number of offices worldwide are gone and buildings in New York, Sydney, and Melbourne are for sale. A majority stake in IMG Artists, a classical music and event business, was sold to financier Barrett Wissman in September. IMG has moved out of the theatrical production business, too, but held on to its booming modeling agency. And the debt, which Kain says was never close to $200 million (though he won't say by how much), is below half that now.

There have even been cuts in the main area of sports. The Racing Club de Strasbourg, a French soccer team that IMG bought in 1998, was sold at a loss. Kain says that IMG would "rather be a supplier than an owner," though it owns other teams. IMG also sold off two of its six women's tennis tournaments, which industry observers say had appreciated in value by 50% over the past two years but were suffering from shrinking margins. While Larry Scott, CEO of WTA Tour Inc., notes that "IMG is still the most heavily invested organization in women's tennis," insiders say midlevel tennis events aren't drawing big numbers.

FOLLOWING THE LEGEND Mark McCormack in June, 2000, and current co-CEOs Bob Kain and Alastair Johnston

STAR POWER

ALL THESE CHANGES happen to coincide with a climate that is heating up for sports marketing in general. "We're starting to see the reality that things are getting better," says rival Rick Dudley, CEO of Octagon, which has faced its own challenges and heavy losses in recent years. But he argues that the days when it was all about snagging the big deal are over. Clients want more partnerships and support to design marketing strategies that fit their needs. In a not-too-su jab at IMG, Dudley argues t "the sales culture of one-s fits-all will not fit in the r world." That means less hi fiving in the locker room more numbers-crunching consulting in the boardroo

No rival can touch IMG at turning stars into franchises

While better business a men may help bring in bucks, success still co down to the stars—and IM the behemoth to beat snatching them up. Manning, pulled in an estimated $42 million year, credits IMG Football President T Condon, who played for the Kansas Chiefs, with getting him the largest tract in NFL history. "He knows hov negotiate, and the fact that he has pla the game means a lot to me," says M ning, who describes himself "low-maintenance" client.

Is there competition? Sure. Urbach of SFX Sports Group I who helped create Michael Jord commercial success, is busy turn client Andy Roddick into a te megastar. "He's a guy that want to be like and women wa date," says Urbach. But what I does better—or at least more sistently—than anyone in the fie turn such stars into franchi Palmer recalls one grueling c mercial shoot as a young golfe 1960, when he quizzed IMG a Jules Rosenthal, about his fu prospects. "I said, 'This is all and good, but what are you goin do when I get old?' Rosenthal's swer: 'We will have established as a business, and you will not b important.'" That, says Palmer, largely proved to be true.

Even with its sharpened focus on its and search for outside money, IM mains steeped in the spirit of its foun Many refer to him in the present t and, when pushed on the company's ture course, still invoke his name. "M McCormack didn't build this busine have it split apart," says Greg Breur director of IMG Academies. But decades of watching their founder rich, insiders feel it's their turn to buil the legacy—and win a chunk of the pire. As Kain puts it: "IMG is not M McCormack and 2,000 dwarfs." ■

–By Diane B

BusinessWeek online To read Q&As with Peyton Manning and Arnold Palmer, go to www.businessweek.com/magazine/extra

The 2004 Full-Size Nissan Titan

a.k.a. "Sport Truck of the Year"

a.k.a. "All-Star Pickup Truck"

a.k.a. "Tow Vehicle of the Year"*

a.k.a. "Most Significant Vehicle of the Year"**

a.k.a. "Pride of Canton, Mississippi"

'e named it the Titan. But thanks to the hardworking people at the new ssan plant in Canton, Mississippi, it has other monikers, too. In *Sport Truck* agazine it goes by "Sport Truck of the Year." It's called "All-Star Pickup uck" In the pages of *Automobile Magazine*. Clearly, the state of Mississippi's ltimillion-dollar investment in job training has paid off, resulting in a whole of great trucks. And more than a little pride.

MISSISSIPPI | NISSAN

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COMMENTARY

BY PETE ENGARDIO

Global Compact, Little Impact

Four years in, the U.N.'s voluntary corporate responsibility plan is falling short

AMID THE HEAT OF the globalization backlash four years ago, as protesters raised mayhem at trade confabs from Seattle to Genoa, Kofi A. Annan made an uncharacteristic gesture for a U.N. Secretary-General: He reached out to Big Business, not a typical ally on U.N. issues. Annan's main project is called the U.N. Global Compact, which has brought together multinationals and activist groups to help ensure that company activities conform to basic human rights, labor, and environmental standards.

By one measure, the Compact has been a smashing success. Its corporate membership has zoomed from 50 charter members in 2000 to more than 1,700. Two dozen global nongovernmental organizations (NGOs) and labor groups also have joined, making the Compact the world's largest voluntary corporate citizenship group, according to a recent McKinsey & Co. study. Membership has expanded beyond the usual European do-gooders, even drawing in U.S. companies that have long been in the activists' crosshairs, such as Gap Inc. and Newmont Mining Corp., plus several companies from nations with bad human-rights and labor records, such as China. And 20 financial institutions, including Goldman, Sachs & Co. and Credit Suisse Group, have agreed to find ways to factor social and environmental practices into stock valuations.

This is all very laudable. Yet to many, even among less-antagonistic NGOs such as Human Rights Watch and Oxfam, the U.N. project is falling far short of expectations. In fact, se groups are so upset that they are threatening to scale back participation. The tensions were on full display at the C pact's annual summit on June 24 at the U.N.'s New York h quarters. At a side event at a nearby hotel, Amnesty Inte tional, Friends of the Earth, and other groups complained the Compact has become little more than a corporate publi lations exercise.

Why the disillusionment? It's largely because the U.N. ha cused more on expanding membership than on finding wa ensure that corporations honor their commitments. The C pact's main goal is to get companies to halt practices that given globalization a bad name, such as the use of sweatsho bor, toleration of atrocities by repressive regimes, and rapac mining and logging in poor nations. Members agree to ad to 10 broad principles, such as recognition of the right to co tive action in the workplace, environmental protection, an spect for human rights, and to explain how they are compl

But four years later, there are still no clear reporting or c pliance standards. While some companies publish exter corporate responsibility reports, including BP PLC and Inc., many others merely state that they follow Compact p ciples and list limited examples in annual reports, such as fi ing for clean-water or AIDS programs in Africa. "I expect transparent process where NGOs can evaluate companies voice their concerns," says Michael H. Posner, executive d tor of Human Rights First. Annan concedes that critics ha point (page 87). While the Compact was never intended to lice companies, "we need to hold them to what they are ing," he says. "If not, this may even discredit the U.N."

Granted, hard-core globalization critics were skeptical f the start because the Compact lacked a rigorous system monitoring corporate behavior and punishing laggards.

Can the U.N. Prod Business To Clean Up Its Act?

The Global Compact pushes companies to ensure that their practices conform with human rights, labor, and environmental principles

PROGRESS

- More than 1,700 multinationals, from Gap to Nestlé, have joined
- Some 20 financial institutions have pledged to factor social and environmental practices into equity valuations

PROBLEMS

- There is no system for activists to verify company claims and few clear standards by which to judge them
- Skeptical activist groups are losing faith, saying their input isn't heeded

Data: BusinessWeek

l, U.N. officials spoke of a system in h corporations could be goaded voluntary compliance by exposing to public censure. Companies d post specifics about what they are to live up to the Compact's basic iples on a U.N. Web site. NGOs l then put their critiques on the site. But this system was shelved use U.N. officials say they lack the rces to manage such a site.

ixed Message

UBLE IS, WITHOUT some way to cly keep companies honest, it's to show that the Compact has ght much change. Although some orate members have model codes of uct, most set them up on their own. for example, already employed 90 rs and outside agencies to monitor sands of garment factories from a to Guatemala before joining the pact. Similarly, new member Star- s Corp. had plans under way to set system with environmental groups sure that most of the coffee it buys es from suppliers who pay poor ers fair prices for beans and treat ers fairly. "The Compact principles require us to do anything different- ays Sandra Taylor, Starbucks' senior president for corporate responsibil- Meanwhile, the Compact also has bers that remain mired in contro- . France's Total, Royal Dutch/Shell p, and Newmont all face civil law- in U.S. courts charging them with ing serious rights abuses in Burma, ria, and Indonesia, respectively. company denies the charges.

n balance, the Compact has done e good. It has become a forum for inationals, NGOs, U.N. agencies, government officials to discuss to set up systems to monitor labor tices and avoid contributing to hu- -rights abuses.

ut if it hopes to salvage its credibili- mong NGOs, the U.N. must now et up enforcement. "We have to now to quality assurance," says al Compact head Georg Kell. One is to drop from membership com- es that fail to detail in annual re- s after two years how they will meet principle.

hat would be a good start. Without a er system for keeping companies st, respected NGOs are in danger of ng. That would be a waste of An- s ambitious effort to address some balization's toughest problems.

Kofi Annan's Business Plan

The U.N. chief talks about how to make the Global Compact more effective

WHILE MOST OF HIS TIME is taken up with crises from Iraq to the Sudan, U.N. Secretary-General Kofi Annan still devotes energy to the Global Compact. He discussed its progress with Senior International News Editor Pete Engardio.

What has the Global Compact accomplished in the past four years?

One of the concrete achievements is that a lot of major companies have signed on and internalized the principles into their organizations. Their own workers are pleased about this, and it sends the message that doing the right thing is good business. We also have been creating a partnership among NGOs [nongovernmental organizations], some of the trade unions, and the business community.

ANNAN "This has not caught on in America as it has in Europe"

How do you respond to complaints by NGOs that the Compact isn't doing enough to ensure that companies live up to their promises?

There is some measure of justification in what they are saying. But this was never introduced as an enforceable code of conduct. We don't have that authority. So we use transparency and dialogue.

Activists also say company efforts aren't transparent, and that there is no forum for publicizing their complaints.

These are areas we are looking at. As we move forward in next 12 months, we will expand into governance. We want to get companies to honor their agreements. Some are publishing their policies in their annual reports, some on Web sites. We need to hold them to what they are saying. The concern of the NGOs is that companies will get a free ride. The Global Compact itself has to have a mechanism to deal with these issues. If not, this may even discredit the U.N.

Why have you put so much focus on reaching out to business in recent years?

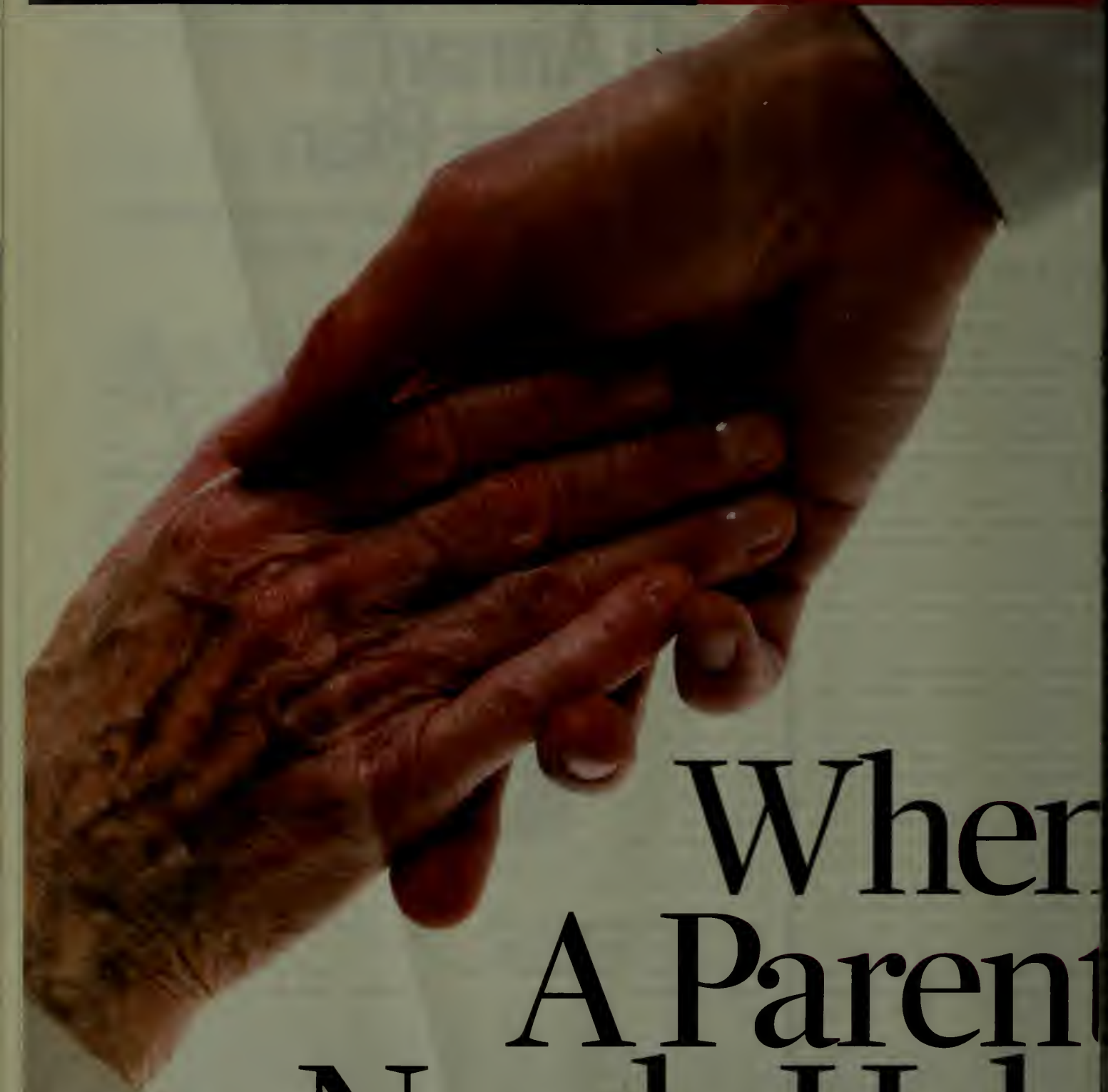
I believe that in the past there was a suspicious attitude between the U.N. and the private sector. But we need business in order to promote development. They are the ones with the money, technology, and management. They are the ones who can create jobs. You can't create sustainable development without creating jobs.

Why have so few American companies joined your initiative?

It is true that this has not caught on in America as it has in Europe. I have been told that some [U.S. executives] worry that if they sign on to the principles, some parties could use that as an excuse to sue them. We received a letter from the American Bar Assn. saying that this should not be a problem. Now we are trying to get the big European and American companies that have joined to explain to other U.S. companies why they should.

What are some of the other initiatives under way with multinationals?

I also have begun working with the pharmaceutical industry. I recently met with CEOs of the top seven companies to reduce the prices of AIDS medications. I think we have seen big progress. Also, we have a working group on the role of the private sector in development.



When A Parent Needs Help

How to pull together an elder care plan that makes sense for yo your siblings—and your parents. **BY HOWARD GLECKM**

O IN THIS SECTION:
Long-term care premiums get pricier
94 Advocates for the elderly
96 Footnotes: *Feng shui* dining
98 Barker: Be wary of buying teentailers

SOMEHOW, DORIS HOUSTON WAS holding it all together. The Champaign (Ill.) researcher in drug addiction was working full-time and completing a PhD at the University of Illinois. At the same time, she was caring for her teenage son. Then, starting about 2½ years ago, she noticed that her widowed, 84-year-old mother, Anna, who lived in Chicago, ıs having memory problems. Houston first arranged for fam- members to stay with her mom. Then Anna suffered a oke. ¶ Although her mother did not want to leave Chicago, ›uston felt she had no choice but to bring her to Champaign. ɜr mother lives with her now, and Houston is juggling par- ting, a full-time job, and her role as caregiver. ¶ Today more an than 30 million Americans are caring for an elderly par- t, according to a study by the AARP and the National Al- nce for Caregiving. As the nation ages, elder care is rapidly coming the biggest family issue facing workers and their ıployers. According to one study, the value of this unpaid re exceeds $257 billion annually. ¶ Caring for aging parents ı responsibility none of us relishes. It create emotional and financial hard- p. You will almost certainly have to e time off from work, and the pres- es of elder care can compromise your ıtionships with spouses, partners, and ldren. You will also tumble headlong › a world filled with such jargon as ac- ties of daily living, skilled nursing fa- ties, and Medicaid spend-downs.

Most painful of all, caring for a frail ent will force you to confront his or mortality. "The hardest part," says uston, "is coming to the realization ıt your parent is in the last stage of e. You know the inevitable is going come."

In this guide to elder care, *Business- ek* will help you think about ways to ll together legal, financial, medical, using, and emotional solutions into a e plan that makes sense for you, your lings, and your parents.

WER OF ATTORNEY

IE BEST ADVICE IS to get started before risis hits. As your parents age—even if y are just in their 60s—you and your lings should discuss legal and financial tters with them. Ask your folks to pre- e or update a will and designate a family member to handle medical and financial affairs. It's essential that you pull together two critical documents. The first, a living will, describes what kind of treatment a person prefers near the end of life or when they are too ill to make those decisions on their own. Ask an attorney to prepare one, or download one from a Web site such as agingwithdignity.org. The other document is a power of attorney. That will allow you or another family member to represent your parents' medical and financial interests. "It's absolutely critical," says Patricia Bray, who is caring for her 86-year-old mother in Florida. "Without it, nobody will talk to you. The doctor won't talk to you. You can't go to the bank."

The family should also figure out in advance who will manage routine chores such as paying bills. "Parents and children have to decide who is going to be the financial caretaker," says Sharon Burns, coauthor with Raymond Forgue of *How to Care for Your Parents' Money While Caring for Your Parents* (McGraw-Hill). "Decision-making should be shared, but one child should be in charge of the tasks."

Remember, your parents have the last word. They may make choices you do not like. For example, they may decide to reduce their taxable estate by distributing assets to family members when you would prefer that they hang on to their money. But legally the decisions are theirs. Your role is to make sure their wishes are met.

You may sometimes hear that when caring for an aging parent, you turn into the parent. Don't believe it, say veteran care managers. You will always be the child and your dad will always be your dad, no matter how frail he becomes. "You can be responsible for your parent without becoming your parent," says Rosanna McLain, a caregiver adviser at Family Service of Champaign County's Senior Resource Center, a nonprofit.

Advance planning makes these issues

Where To Go for **Help**

ADVICE AND ADVOCACY

AARP
aarp.org

Caring From a Distance
cfad.org

National Alliance for Caregiving
caregiving.org

Nat. Assn. for Homecare & Hospice
nahc.org

National Family Caregivers Assn.
nfcacares.org

GOVERNMENT

Center for Medicaid & Medicare Svcs.
1 800 MEDICARE or medicare.gov

Eldercare Locator
1 800 677-1116 or eldercare.gov/eldercare/public/home.asp

State Health Insurance Programs
medicare.gov/contacts/related/ships.asp

OTHERS

Alzheimer's Association
1 800 272-3900 or alz.org

Home Renovations for the Elderly
homemods.org

Oncolink (Cancer Help)
oncolink.upenn.edu

Data: BusinessWeek

FREQUENT VISITS Bray and her mom, Grace Cooper

far easier. Having to confront them during a crisis can be overwhelming. Still, sooner or later you'll realize that mom can no longer care for herself, or you'll get that 5 a.m. phone call telling you your dad has just had a stroke. What do you do?

"Get a grip," says Nora Jean Levin, executive director of Caring From a Distance (CFAD), a Washington nonprofit aimed at aiding long-distance caregivers. "If it is a medical emergency, you'll first need to get a handle on that. Once the crisis has passed, you can figure out the long term."

First, you'll need to know what you are dealing with. If mom is in the hospital, catch doctors early in the morning when they are making rounds. Learn as much as you can about your parent's medical condition. If a physician won't communicate openly with you or your parent, get another doctor. For additional information, check out disease-specific Web sites (table, page 89).

If you have not done it already, you'll need to sort out money issues. What assets does mom have? What is her cash flow—pension and Social Security income, interest, and dividends? That will tell you a lot about what housing and other options are realistic.

You'll need to think about Medicaid, too. That's the low-income health program run by the states which is increasingly paying for nursing care of seniors. Medicare does not pay for long-term custodial care. But Medicaid does foot the bill for those seniors who cannot afford it. You are almost always better off spending your parents' assets, rather than your own, on long-term care. But when their cash runs out, you'll need to decide: Will you let Medicaid fund their medical needs, or will you pay out of your pocket for higher quality care?

Once you've pulled together basic medical, legal, and financial inform it's time to get outside help. Start your local area agency on aging (These federally funded clearingh can get you a wide range of inform on elder-care services. They can te about local home-health agencies sisted-living facilities as well as refe to free or low-cost government prog for housing, transportation, and m

As government entities, AAAs can ommend, say, a specific home agency. For that guidance, check wi vate information and referral se You can get a list from your local agi fice, or check the phone book under ior services. Many are faith-based profits. The Episcopal and Ca churches, for example, provide info tion through local organizations ar the country. Their help is availab everyone, no matter what their reli They can help you narrow your op often by assigning a staffer to work detailed plan of care. That's McLain did for Doris Houston. "My ground is in social work," says Hou "But with elder care, I was starting ground zero. I didn't have a clue."

With McLain's help, Houston p together a plan. She retrofitted a room in her home and arranged homemaker who comes for a few five days a week to help with cookin keeping an eye on her mom. An found a state assistance program

For many senior staying at home not only possible it's the best optio say elder-care experts

helps with her mother's monthly dru of nearly $700.

If you need even more help, you turn to a private geriatric care man (page 94). Wherever you get ad you'll have to confront a critical sion: housing.

These days, seniors can choose fr broad range of choices, including ass living, nursing homes, and contin care centers (table, page 91). Which you pick will largely depend on your ent's health and financial wherewi Involve your parent in the choice. I

Housing **Options** for Seniors

eniors and their families are confronted with a bewildering choice of housing options. Which one works best for you (or your elderly relatives) depends on your age, interests, health, and, of course, your finances.

	WHAT IS IT?	PROS	CONS	COST*
DEPENDENT ING	Primarily a social, not a medical, setting, independent living is for active seniors who can care for themselves. It accommodates a broad range of lifestyles, often includes in-house activities, and may provide transportation to shopping and outside events. Some have dining rooms that serve one or two meals a day, though individual units have full kitchens. Some offer assisted living on site. You may rent or buy.	Resort-like ambience. Plenty of activities. No need to worry about maintenance and repairs of a home.	If you become frail or sick, you'll have to hire private aides at substantial extra cost, or you may have to move.	$1,168 to $2,234 a month
SISTED ING	These communities are for seniors who have difficulty managing on their own. They provide a moderate level of personal care, such as assistance in bathing or taking medications. Individual units, usually rented monthly, are often efficiency-style, with limited or no cooking facilities. Resident may have to pay for extra care.	Good choice for frail elderly who can manage with some help from aides. Less costly and much more comfortable than nursing homes.	Staffs are often overworked, and it's hard to get personal attention. Management often has trouble managing medical requirements of patients. Some facilities are appropriate for residents with mild dementia, others are not.	$2,703 to $4,177 a month
SING ES	These offer a much more intense level of medical care, usually under the supervision of a doctor. Today, many nursing homes are geared to dementia patients, limited stays for rehabilitation, or patients at the end of life.	Can provide near-hospital-quality medical care for chronic illness at less cost. On-site physicians and RNs can quickly respond to changes in patients' health status.	Private rooms are expensive and often unavailable, so residents may need to share a room. Mixing mentally able patients with those suffering from dementia can create problems. Staffs are overburdened.	$172 to $248 a day
NTINUING RE MMUNITIES	Also known as life-care communities, they try to provide facilities for all stages of aging on the same campus. They usually include independent and assisted living, as well as nursing and rehab care. CCRCs charge hefty entry fees plus monthly payments. Some are operated by nonprofits or church groups, others are for-profit.	These make it easy to move between levels of care as the resident's condition changes. Seniors may maintain contact with friends as they move within the same community.	They require a major, long-term financial commitment. Residents or their families need to assess stability of the facility's ownership and management.	Entry fees $81,115 to $358,671. Monthly charges of $1,748 to $4,641.
YING AT E	Often forgotten in the scramble for alternative housing, remaining at home, with its familiar surroundings and proximity to friends and neighbors, is the best choice for many seniors. Some senior-heavy apartment complexes are creating their own informal support systems.	Avoids wrenching change. Allows seniors to maintain a sense of independence. Care can be tailored to specific situations. Hired aides provide more personal, one-on-one care.	Finding and monitoring resources, such as shopping, transportation, and home health aides can be complex and time-consuming. Renovations may be required. Not necessarily cheaper than other alternatives.	Home health aides earn about $12 to $18 an hour.

* vary dramatically around the country. For instance, the annual average cost of a nursing home in New York tops $100,000, while in Jackson, Miss., the average is about $46,000. pare the relative costs of various housing choices, we focused on 2003 prices in one area, the Virginia suburbs of Washington

Data: *Guide to Retirement Living*; *BusinessWeek*

decide a care facility is best, shop carefully. Talk to staff and residents about the facility and services. Be sure to inspect the residents' rooms, and don't be fooled by a fancy lobby.

Despite all the commercial options, three-quarters of the elderly still live in their own homes or with family members. Elder-care experts agree that staying at home is not only possible but, for many seniors, is the best option. "It is familiar, it is close to friends and family," says Ellen Greenberg, director of the Senior HelpLine of the Jewish Council for the Aging in Rockville, Md. "If you take that away, it is a loss."

Staying at home takes effort, however. It requires a caregiver to pull together many different services into a coordinated plan. By contrast, an assisted-living facility offers one-stop shopping for nearly all of a senior's needs.

Home care may also require renovations to improve safety. According to Stephen Hage, president of Strategies for Independent Living, a Takoma Park (Md.) construction company that remodels homes for the frail elderly, the costs are modest. For someone who is not wheelchair-bound, a home can be retrofitted for less than a few thousand dollars—by installing safety rails, eliminating raised thresholds between doors, and simply moving furniture and doing away with throw rugs. "Fall prevention is key," Hage says.

Still, staying at home does not always work. As medical needs increase and more nursing care is required, costs can become prohibitive. For seniors living alone, loneliness can be a huge p lem as well, especially if they ca longer drive and their own friends d move away.

A parent's loneliness is one of r challenges for the 6 million careg who live an hour or more from thei ing or frail relatives. Ask Patricia Bra international tax attorney at the Int Revenue Service. Bray lives in Vie Va., but her mother, Grace Cooper, Merritt Island, Fla. Cooper, who will 86 in August, ran her own property m agement business until last year. But betes and pneumonia hospitalized twice in late 2003. Those problems been compounded in recent month memory loss.

Bray, an only child, at first relie relatives in Florida to keep an eye o

Providing for Your Own Care

Long-term care insurance is getting even more pricey, so shop carefully. BY HOWARD GLECKMAN

YOU MAY THINK YOU have enough on your plate caring for your aging parents. But ponder this: If you are thinking about buying insurance to pay for care you might need yourself one day, it's getting more expensive and more complicated.

Long-term-care coverage, which pays for nursing homes and at-home health aides, has proven more costly to insurers than they expected when they first rolled out LTC policies 20 years ago. As a result, they've started to pass on their added burden to consumers in the form of higher premium prices and tougher underwriting terms that are boosting rates even more for the less-than-healthy.

In the past year they've raised premiums for new individual policies 5% to 10% on average, while typical group rates jumped 14%. Prices for some policies have grown even faster. For example, a 55-year-old single male living in Maryland would pay John Hancock Life Insurance $2,945 annually to buy top-of-the-line coverage today—40% more than for a comparable policy two years ago. Some companies, such as CNA Financial, have even raised rates for existing policyholders. That's allowed under most contracts, though only across-the-board and not for individual customers. In the past, carriers had been reluctant to do it, fearing bad publicity and consumer backlash.

LOW LAPSE RATE

WHY THE RATE HIKES? Many companies deliberately underpriced policies to boost market share. Then a sagging stock market and low bond yields ruined their investment returns. Their biggest problem was that more seniors than expected actually filed claims. Insurers figured many customers would get tired of paying premiums after a number of years and drop the coverage before they needed it. As it happened, the percentage of cies customers let lapse fell from clo 10% a decade ago to roughly 1% t says Peter Goldstein, executive vice-p ident of Long Term Care Group, an E gundo (Calif.) consulting firm. Tha forced carriers to increase cash res

her. But after her mom's nd hospitalization, Bray zed her mother's needs more than her relatives d manage. With the help care consultant in Vir- and a geriatric care ager in Florida, Bray d an assisted-living facil- ot far from her mother's e. She also discovered a ncial assistance program military widows such as mother.

Caring for a parent forces families to face issues often long ignored

he stress of overseeing care from 0 miles away is tremendous. "I sweat ts about running out of money," Bray . "And I worry that I'm not being sen- enough to what my mother is really ng." Although she has a care manager keeping an eye on things, Bray flies to Florida every three weeks to check on her mother.

CFAD's Levin says it is natural for children who live far from their parents to visit with a full calendar of things to do: Consult with the doctor, pay the bills, make sure the home health aide is working out, or check with the management at the assisted living place. But she warns to be careful about "swooping in with a list" only to leave when the chores are done. Reserve some time for quietly sitting and visiting, Levin advises.

Elder-care experts say stress can take a huge physical and emotional toll on caregivers. Helping a frail parent forces families to confront sensitive issues they may have spent decades sweeping under the rug. Resentments among parents and their children, sibling rivalries, feelings of guilt, anger, and fear—it all bubbles up, especially in the face of a medical crisis.

The opportunity to care for an aging parent can also be a blessing. It can bring parents and children closer and help adult children discover strengths they never knew they had. But it is still hard for everyone involved. Caregivers can make their lives and the lives of their elderly parents much easier by seeking out help. Remember, whatever your financial and emotional resources, you are not alone. ■

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must hold against future claims. t the same time, insurers have ned more about who is likely to re- e care. The result: far tougher under- ing. Carriers used to ask just a hand- of questions before selling a cy—especially to younger people. ir main interest was in assessing your of dementia, especially from heimer's disease. Now they want to w lots more about your health. And being overweight or having a bad c can be enough to boost your initial nium. That 55-year-old from Mary- who would pay $2,945 as a low-risk omer would spend $520 a year more standard risk. Higher-risk patients, as those taking insulin for diabetes, often uninsurable. Some companies considering new, high-risk policies— a lot stiffer premiums.

VER PLAYERS

THER WORRISOME trend is consol- ion in the insurance industry, which slashed competition in many mar- . For instance, only three companies safety ratings of B or better even of- insurance to that 55-year-old Mary- ler, according to Weiss Ratings of ter, Fla. Overall, LTC carriers have n from about 140 three years ago to or fewer today, estimates Thomas , founder of Web site LTC Link ink.net). Among the players that have pped out: Conseco and AIG.

What can you do to soften the blow of her premiums? To start, think about v much coverage you need. For in- nce, premiums for a policy that covers for six years can be 50% higher than for a contract for four years of coverage. But so far, 83% of claims have been for three years or less, according to a study by Long Term Care Group.

If you are healthy, you should also think twice about buying group coverage through your employer or trade association. Unlike health insurance, in which your company picks up most of the cost, you'll usually pay the entire premium for long-term-care insurance. And because group policies don't screen out all higher-risk workers, premiums are more costly for everyone. "If group is the only way to get the coverage, that's where you go," says Thomas West, a McLean (Va.) financial planner. "But you might get the best deal on your own."

Before you buy any policy, check into whether the carrier has imposed big premium increases on existing customers. If it has, look elsewhere. It is a warning of potential financial problems—and could mean future rate increases. But the best advice may be the most obvious: With a product as complex and costly as long-term-care insurance, it pays to do plenty of homework. ■

What You Need to **Ask** About Long-Term-Care Insurance

DAILY BENEFIT What is the maximum amount per day the insurance will pay? You probably want at least $100. An extra 5% inflation option helps protect against rising health costs, but premiums will be higher.

BENEFIT PERIOD How long will you be covered? Typical policies range from two to six years. But nearly all claims are for three years or less.

POLICY LIMIT What's the maximum dollar amount your policy will pay out? A four-year policy at $100 a day will pay up to $146,000.

ELIMINATION PERIOD It's really just the deductible—how long you will pay for care before coverage kicks in. It can be between 30 and 90 days. The shorter the period, the higher the premium.

BENEFIT LIMITS How much coverage will you get if you stay at home, rather than enter a nursing home? How sick must you be before making a claim? Who makes that determination?

INSURER SAFETY You may pay premiums for 30 years before making a claim. Will your insurer still be around? Check rating services such as A.M. Best (ambest.com), Standard & Poor's (www.standardandpoors.com), or Weiss Ratings (weissratings.com) to learn how solid your insurance company is today.

Sometimes You Need an Ace

A geriatric care manager can help you cope with an aging relative. **BY SUSAN GARLAND**

TEAMING U
The Martin
and Kutchk

TWO FAMILIES STRUGGLING with the needs of aging relatives, the geriatric care manager can be a godsend. This emerging breed of specialist can assess a senior's physical, social, and financial needs and stitch together a patchwork of services to address them. The cost: about $300 to $800 for an initial assessment, and $50 to $150 an hour after that.

If you're in the market for such a person, be aware that the profession is virtually unregulated: The feds don't monitor it, and only one state, New Hampshire, requires licensing. As the demands of the older population grow, the field is wide open to practitioners with little experience in dealing with the variety of issues the elderly face. Cathy Cress, president of Cresscare Case Management Agency for Elders in Monterey, Calif., says accounting and financial-planning firms and home-health agencies are starting to offer geriatric care management, too. Although these professionals may be trained in some facets of elder care, she says, families need to check credentials carefully. "These are incredibly complicated problems, and geriatric care managers must be experts in multiple domains," explains Cress, who teaches courses on geriatric care management for San Francisco State University's master's in gerontology program.

In short, a skilled geriatric care manager is a "jack of all trades," says Tara Eisner, who works for LivHome Corp. in Los Angeles. You can hire one to supervise home-care aides, retain an attorney for legal problems, arrange for transportation for visits to doctors and shopping trips, fill out endless forms for benefits programs, and act as a family's advocate with hospitals and physicians. Adult children who live far away look to care managers to visit their parents regularly and to keep them informed, she says. Although she will help place a senior in an institutional setting, Eisner says her goal is to keep an older person at home: "We want them living an independent life so they can age gracefully."

GETTING INSURERS TO BUDGE

THAT'S WHAT NIKI MARTIN, 50, of Sunnyvale, Calif., is trying to do for her 78-year-old father, Nick, who lives with her. She turned to Cresscare in early April for help with her father, who had suffered several strokes. He had also been diagnosed with a brain tumor that was causing violent behavior. The care manager, Stephen Kutchko, found a daily outpatient treatment program for her father, persuaded a reluctant insurance company to pay for a home-care aide, and arranged for a wristband transmitter in case her father wandered off. Kutchko plans to spend an hour and a half a week on the Martin case. Martin, who works full-time as an executive assistant at Agilent Technologies, says the service provides her with the "expertise to navigate a very complicated, cumbersome system." She signed a contract, which included a $500 deposit and an hourly fee of $85, although might be some other costs dependi her dad's needs.

Like Martin, relatives usually seek during a crisis when they do not time for an in-depth probe of a care ager's training. So if you think you need this sort of help, start looking a of time (table).

Make sure the manager is licens a social worker, a registered nur therapist, or care-related professi The best place to start is the Nationa sociation of Professional Geriatric Managers, whose members must certain standards. Anyone you should have several years' experien providing assessments of and servic the elderly and a list of recent refere

Also inquire how the manager w handle family squabbles over care. sha Pierson, a care manager with Ion nior Services in Washington, says sh mediate disputes among siblings. "W to neutralize the family dynamics of and anger and meet the needs of the ior," she says.

Although costly, a geriatric care ager may offer something money buy. By lightening the burden of h to unravel the perplexing web of care services on their own, families w able to make the most of those last with their aging relative. ■

Where To Find Help

- Aging Network Services, agingnets.com
- Eldercare Locator, eldercare.gov or 800 677-1116
- National Association of Professional Geriatric Care Managers, caremanager.org
- SeniorBridge Family Cos., seniorbridgefamily.com

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EDITED BY TODDI GUTNER

LOANS

A GREAT TIME FOR A STUDENT TO BORROW

INTEREST RATES may be heading up. But when it comes to student loans, they've never been lower. Indeed, through June 30 of 2005, students can get a federally guaranteed Stafford loan for just 2.77%. Meanwhile, federal PLUS loans for parents are 4.17%, and the rate for graduates repaying loans is 3.37%. All are 0.05% below last year's rates. Why the decline? The rates are based on a Treasury bill auction held in May, when lower rates prevailed. But since they're reset annually, the bargains may not stick around in another year.

TRAVEL

BABYSITTING FOR A B&B

SO YOU DREAM of operating a bed and breakfast. You can, without the financial commitment or full-time responsibility. Interim innkeepers are in demand to spell burnt-out B&B owners. The pay is only $150 to $250 per day, but you get to travel and stay in lovely places. Start by signing up for inn-sitting training with the **Bed & Breakfast Institute of Learning** (bbinnstitute.com), **Interim Innkeepers Network** (innsitter.bigstep.com), or **Inn Caring** (inncaring.com). Courses usually last three days and cost $200 to $400. *–Kate Murphy*

TIME OFF

Food and Spirit

***FENG SHUI*, CHINESE FOR WIND AND WATER, IS** an ancient tradition of design and o placement used to create harmony and balance. We've seen it used increasingl homes and offices in the past decade; now it is spreading to restaurants.

The latest example is **Kittichai**, a new Thai restaurant in New York's SoHo se The first *feng shui* feature a visitor notices is a tank of eight goldfish inside a ba bird cage at the entrance. Eight symbolizes infinity, which translates into unlim happiness. The dining room is built around a reflecting pool for harmony and prosperity. "If people have a good feeling, they will come back again," says Ho Kong-based *feng shui* master Patrick Wong, who designed Kittichai.

Other restaurants employing *feng shui* include **Japango** in Boulder, Colo.; **Se** in Farmington, Pa.; and **Crustacean** in Las Vegas, Beverly Hills, and San Francis Does *feng shui* really work? Who knows? But with shares of **P.F. Chang's China Bi** soaring 160% in four years, the chain is unlikely to monkey with its *feng shui* elements of mirrors and ambient light anytime soon. *–Lauren*

EMPLOYMENT

IF YOU'RE JOB HUNTING, don't pad your résumé with meaningless phrases such as "results-oriented." Instead, gi specifics, says ResumeDoctor.com. The online consultant looked at 160,000 résumés and found that more than half u vague statements to describe work skills and experience.

% OF RESUMES	PHRASE
12.6	COMMUNICATION SKILLS
7.2	TEAM PLAYER
5.5	ORGANIZATIONAL SKILLS
4.8	INTERPERSONAL SKILLS
4.3	DRIVEN

% OF RESUMES	PHRASE
4.2	DETAIL-ORIENTED
3.8	RESULTS-ORIENTED
3.8	SELF-MOTIVATED
3.2	PROBLEM SOLVER
3.1	HIGHLY MOTIVATED

Data: Resume

AHH, ROOM WITH A VIEW."

-GOLDEN RETRIEVERS IN BACK OF ENVOY XUV

For a full product demo [illegible] go to www gmc com envoyxuv

ENVOY XUV. WITH SO MANY INNOVATIVE FEATURES, FRIENDS—INCLUDING FOUR-LEGGED ONES—WILL BE IMPRESSED WITH THE GMC ENVOY XUV. IT'S THE FIRST AND ONLY SUV WITH A POWER-SLIDING REAR ROOF. IT ALSO FEATURES A TAILGATE THAT DROPS OR SWINGS, AND A FOLD-DOWN MIDGATE WITH POWER GLASS THAT SEALS OFF PASSENGERS FROM THE ALL-WEATHER CARGO AREA. WITH ALL OF THESE FEATURES AS WELL AS THE POWER AND COMFORT FOUND IN EVERY ENVOY, IT'S NO WONDER THE ENVOY XUV IS THE SPORT UTILITY WITH MORE UTILITY. PROFESSIONAL GRADE ENGINEERING. IT'S NOT MORE THAN YOU NEED. JUST MORE THAN YOU'RE USED TO.

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BY ROBERT BARKER

Teentailers: Too Hot Not to Cool Down

Anyone with teens at home (I have two) knows there simply is no anticipating their clothing whims. One kid may be drawn to designer boutiques, while the next one prefers checking eBay for vintage T-shirts or making the rounds of thrift stores, where bags of back-to-school wear are often sold by the pound.

Investing in "teentailers," such teen-focused retailers as Abercrombie & Fitch or American Eagle Outfitters, is nearly as bewildering. The five with market values of at least $1 billion (table) this year returned an average of 57% through June 28 (vs. 2.6% for the Standard & Poor's 500-stock index). Yet I figure further gains will be more grudging, given the profit-growth outlook and a crowded market for teen apparel.

AT THE FLORIDA MALL IN ORLANDO, besides Abercrombie and American Eagle, I found Pacific Sunwear, Rave, Urban Planet, Billabong, Aeropostale, Gadzooks, No Fear, dELiA's, Wet Seal, Surf Zone, Hot Topic, and more. There were differences, naturally. Music blared loudest at Abercrombie; PacSun displayed the most frantic clearance signs ("Girls' tank tops 2 for $20"). Yet store to store, most striking was how many of the garments looked interchangeable. Two girls I spotted leaving American Eagle were Cristina Ortiz, 15, and Ciara Rosario, 16. Their favorite store? Cristina shrugged and pointed to her T-top, with Aeropostale's logo. "They always have a lot of sales," she said. Glancing back at American Eagle, she added: "There's not really much difference. They have the same clothes."

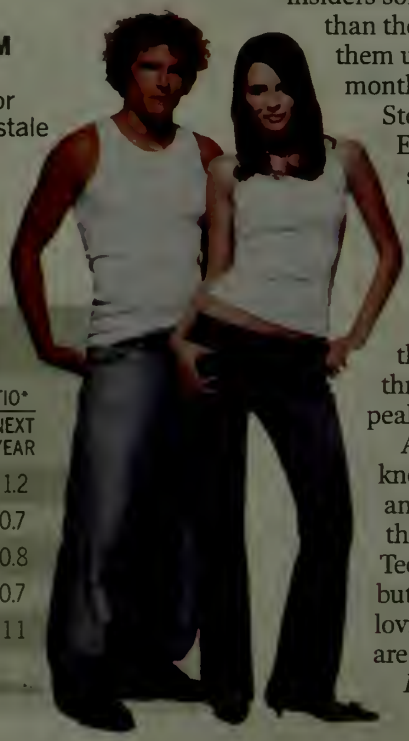
Not five miles away at the newer, tonier Mall at Mille which has many of the same teen stores, I heard a simil note of ennui. There, 19-year-olds Jamie Contractor anc Rachel Streitfeld rolled their eyes at today's dominant s "It's not that we don't like Abercrombie," Rachel said. " just that look—like, 'Summer Girl'—is really annoying. really cookie-cutter." They prefer the "wacky" thrift-sto of Urban Outfitters, with housewares and toys (action fi of Jesus, for $8, and Moses, $10). Yet the clothes, from Converse sneakers to $24 scoop-necked jerseys, on sale $15, might also be found at many competing stores.

Teentailers aren't about to go bust. Abercrombie has debt-free balance sheet and began this year to pay a div American Eagle's board is weighing a dividend more seriously, too. But slower earnings growth is in store for coming fiscal year, beginning in February. American Ea chief financial officer, Laura Weil, told me she expects p margins to keep widening this year and next. "We know can improve," she said. But quarterly comparisons will inevitably get tougher, a fact Abercrombie underlined re when it warned against expecting much in margin gain

Stepped-up sales of stock by insiders at some teentail hardly heartening, either. In the past 12 months, Abercr insiders sold 1.5 million more sh than they bought, with 47% them unloaded in the past t months, according to Vicke Stock Research. At Ame Eagle, 75% of the 7.5 n shares sold in the pas were dumped this sp Contrast this with PacSun. Its insiders a net 2.2 million sha the past year, but 11% that action came in the three months. PacSun sl peaked in February.

Anyone with teens at h knows that, with all of th and downs of adolescen they need unconditiona Teentailers are just as vo but investors are better o loving them only when th are down. ■

E-mail: rb@businesswe



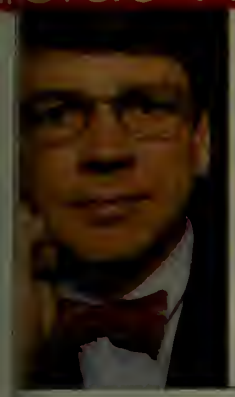
UNIFORM DUDS An ad for Aeropostale

The Fickle Finger of Fashion

COMPANY/SYM	STOCK PRICE	ESTIMATED EPS GROWTH THIS YEAR	ESTIMATED EPS GROWTH NEXT YEAR	PEG RATIO* THIS YEAR	PEG RATIO* NEXT YEAR
Abercrombie & Fitch ANF	$38.92	19%	12%	0.8	1.2
Aeropostale ARO	27.83	40	24	0.5	0.7
American Eagle Outfitters AEOS	29.50	104	18	0.2	0.8
Pacific Sunwear of Calif. PSUN	20.73	32	19	0.5	0.7
Urban Outfitters UR[illegible]	62.20	50	25	0.7	1.1

[illegible] estimated [illegible]ngs gr[illegible]

Data: BusinessWeek, Standard & [illegible]



BY DAVID HENRY

INTERNATIONAL RECTIFIER COULD SHOW SURPRISING SPARK.

INSURER MONTPELIER LOOKS SET TO BUCK INDUSTRY TRENDS.

SELLING B&W EASES BRITISH AMERICAN TOBACCO'S RISK.

ıat Old Electric Surge

S NAME SOUNDS LIKE A throwback to 40 years ago, hen 'tronics stocks were hot. But today, International ectifier (IRF) seems as plugged into the future as ever. It s increasingly specialized electric devices for energy- ent appliances and cars, as well as r control chips used in uters, telecommunications, and ary weapons. Think variable- l washing machine motors, ic turbochargers, drone aircraft, 25% long-term earnings growth, Edward Hemmelgarn of Shaker tments, which owns 1.5% of the billion stock. Hemmelgarn says he stock, which has foundered with semiconductor stocks tly, is headed from 41 to 60 by ime next year. His argument: Rectifier's business is ing where it counts most, in high-profit-margin products ıse its special technologies. Proprietary products, as sed to commodity items, generated 60% of revenues in uarter ended March, up from about 50% two years re. At the same time, gross profit margins climbed to 40% 30%. Analysts tracked by Thomson First Call estimate ompany earned $1.59 for the year through June 30. They ct $2.54 next year. Standard & Poor's says Rectifier is attractive than peers in semiconductors. Its target on tock is $55 within 12 months.

READY TO TURBOCHARGE?

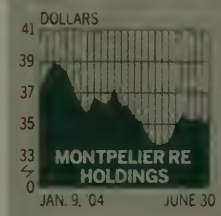
Data: Bloomberg Financial Markets

ıe Insurer ıat's On Dry Land

ODAY, THE MARKET IS generally fearful of stocks of property and casualty reinsurance companies. The rap is that their premium rates are slipping and their stment returns from bond holdings are in jeopardy ıuse of rising interest rates. But in that discouraging ook, Scott Black of Delphi Management finds opportunity. s buying Montpelier Re Holdings (MRH). "It is a solidly business for a 7 p-e. That's ridiculously low," says Black. Montpelier trading at 35 and estimated earnings from ysts this year of $4.82, Black sees the price climbing ly 30%, to $45 in a year, on top of a 3.9% yield. ıorized stock buybacks, for perhaps 6% of the shares, l to boost returns higher. Book value is approaching $30.

Setting Montpelier apart are its low costs this past year of just 50% of premiums for losses and expenses combined, vs. about 75% for its peers. Selling through brokers holds down expenses. Montpelier's fixed-income investments have a short duration of 2.1 years, putting it in good position for rising rates. Deutsche Bank insurance analysts rank Montpelier a buy with a target of 45.

SAFETY IN ITS NUMBERS

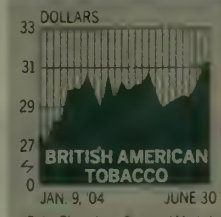


Data: Bloomberg Financial Markets

British American: Tobacco Without the Flames

JUST AS SMOKERS CRAVE cigarettes without cancer risk, investors long for tobacco company cash flows without litigation risk. At British American Tobacco (BTI), the fear of litigation, if not the fact, is being eased by the sale of its U.S. business, Brown & Williamson Tobacco, to R.J. Reynolds Tobacco. The stock rose 5% after U.S. regulators approved the deal on June 22. David Winters, CEO of the Mutual Series mutual funds, which own 2.5% of the stock, says: "Even from here we'll make another 20% to 30%" in 12 months. Also, the dividend yields nearly 5%. Shares trade at about 10 times 2005 estimates by analysts, says Thomson First Call. Winters says earnings per share will grow about 15%. The reason: Synergies from deals and cost savings at headquarters will lift earnings and fund buybacks to reduce shares outstanding. The company is just starting to reap benefits from buying Ente Tabacchi Italiani in December. It will own 42% of the new RJR. Growth should come from emerging-market countries with growing populations. Morgan Stanley analyst Jonathan Fell sees shares rising only 4% but says the cash flows are attractive at a time of low market returns.

WAITING TO EXHALE



Data: Bloomberg Financial Markets

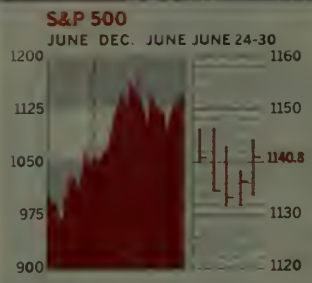
Gene Marcial is away for several weeks.

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/ today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays. See Gene on Fridays at 1:20 p.m. EST on CNNfn's *The Money Gang*.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

Personal Business Figures of the We

STOCKS



COMMENTARY

Despite some jitters, the Fed was true to its word, raising rates a quarter-point on June 30, the first increase in four years. Stocks and bonds turned higher, but investors remain wary that the spoonful-of-medicine approach won't be enough to nip inflation. Although indexes were basically flat last week, look for the action to pick up this week as companies report earnings.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	JUNE 30	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1140.8	-0.3	2.6	17.1
Dow Jones Industrials	10,435.5	-0.4	-0.2	16.1
NASDAQ Composite	2047.8	1.3	2.2	26.2
S&P MidCap 400	607.7	1.0	5.5	26.5
S&P SmallCap 600	296.4	1.9	9.6	34.1
Russell 3000	647.5	-0.1	2.8	18.4
SECTORS				
BusinessWeek 50*	654.2	-0.6	5.2	13.0
BW Info Tech 100**	350.2	1.5	-0.1	14.5
S&P/BARRA Growth	567.4	-0.4	2.1	14.5
S&P/BARRA Value	569.2	-0.2	3.1	19.7
S&P Energy	250.8	-1.5	11.9	28.7
S&P Financials	384.4	-0.3	1.2	16.5
S&P REIT	119.2	-0.4	3.0	19.2
S&P Transportation	206.9	1.5	2.5	16.8
S&P Utilities	120.5	-0.4	1.8	7.2
GSTI Internet	167.6	2.5	15.9	35.4
PSE Technology	735.4	2.1	5.5	30.8

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	JUNE 30	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1187.7	1.3	0.8
London (FT-SE 100)	4464.1	-0.5	-0.3
Paris (CAC 40)	3733.0	0.3	4.9
Frankfurt (DAX)	4052.7	2.7	2.2
Tokyo (NIKKEI 225)	11,858.9	2.4	11.
Hong Kong (Hang Seng)	12,285.8	3.7	-2.3
Toronto (S&P/TSX Composite)	8545.6	-0.3	4.0
Mexico City (IPC)	10,281.8	1.4	16.9

FUNDAMENTALS

	JUNE 29	WEEK AGO
S&P 500 Dividend Yield	1.63%	1.63%
S&P 500 P/E Ratio (Trailing 12 mos.)	21.1	21.1
S&P 500 P/E Ratio (Next 12 mos.)*	17.0	16.9
First Call Earnings Revision*	1.10%	1.22%

TECHNICAL INDICATORS

	JUNE 29	WEEK AGO
S&P 500 200-day average	1097.8	1094.9
Stocks above 200-day average	67.0%	64.0%
Options: Put/call ratio	0.69	0.74
Insiders: Vickers NYSE Sell/buy ratio	3.12	3.16

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Constr. & Engineering	17.9	Internet Software	121.8
Steel	17.8	Fertilizers & Ag. Chems.	77.9
Internet Software	17.8	Oil & Gas Refining	77.7
Fertilizers & Ag. Chems.	11.6	Steel	77.6
Food Chains	9.9	Internet Retail	76.5

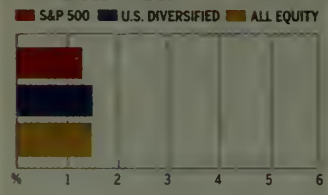
WORST-PERFORMING GROUPS

	LAST MONTH %	
Advertising	-4.9	Airlines
Hypermkts. & Suprcntrs.	-4.4	Broadcasting
Food Wholesalers	-4.3	Biotechnology
Genl. Merchandise Chains	-4.0	Intgrd. Telecomms. Sv
Broadcasting	-4.0	Insurance Brokers

MUTUAL FUNDS

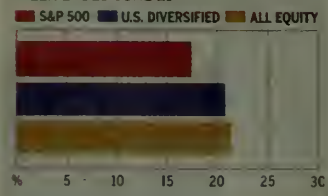
4-WEEK TOTAL RETURN

WEEK ENDED JUNE 29



52-WEEK TOTAL RETURN

WEEK ENDED JUNE 29



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Japan	6.4	Japan	48.0
Natural Resources	4.2	Small-cap Value	33.1
Small-cap Value	3.0	Natural Resources	32.7
Communications	2.8	Diversified Pacific/Asia	32.4
LAGGARDS		**LAGGARDS**	
Precious Metals	-3.8	Domestic Hybrid	10.9
Pacific/Asia ex-Japan	-2.1	Utilities	12.6
Health	-1.4	Large-cap Growth	15.1
Diversified Emerg. Mkts.	-0.3	Large-cap Blend	15.9

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFunds Ult. Japan Inv.	10.9	Fidelity Japan Small Co.	86.3
Fidelity Japan Small Co.	9.1	Pacific Advs. Sm. Cap A	75.5
J.P. Morgan Flem. Jap. A	8.3	Matthews Japan	71.1
ProFds. Wriss. Ultsr. Inv.	8.2	Japan Smaller Companies	64.6
LAGGARDS		**LAGGARDS**	
Oppenheimer Real Asst. A	-10.2	ProFunds UltSh. OTC Inv.	-41.8
Frontier Equity	-10.0	Rydex Dynam. Vent. 100	-41.7
PIMCO Cmdty. R. R. Instl.	-8.9	Potomac Sm. Cap/Sh. Inv.	-30.2
PFds. Pr. Mtls. Usr. Inv.	-7.1	Rydex Dyn. Tempest 500	-29.9

INTEREST RATES

KEY RATES

	JUNE 30	WEEK AGO
Money Market Funds	0.71%	[illegible]
90-Day Treasury Bills	1.29	1.28
2-Year Treasury Notes	2.70	2.73
10-Year Treasury Notes	4.58	4.70
30-Year Treasury Bonds	5.29	5
30-Year Fixed Mortgage †	6.22	6.22

†Ba

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-
General Obligations	[illegible]	
Taxable Equivalent	5.74	
Insured Revenue Bonds	4.20	
Taxable Equivalent	6.00	

THE WEEK AHEAD

NONMANUFACTURERS' INDEX *Tuesday, July 6, 10 a.m. EDT* » The Institute for Supply Management's June nonmanufacturing-activity index is forecast to have eased slightly, to 64.5%. That's according to the median forecast of economists surveyed by Action Economics. For May, the index slipped to 65.2%. The expected June reading would still be far above the long-term average of 57%.

INITIAL UNEMPLOYMENT CLAIMS *Thursday, July 8, 8:30 a.m. EDT* » New filings for state unemployment claims most likely totaled about 345,000 for the week ending July 3. The claims figures can be volatile around the July 4th holiday as auto companies shut down their plants for the annual model-year changeover. Although recent readings have ticked up a little compared with data from early 2004, current levels still suggest further improvement in the labor market.

INSTALLMENT CREDIT *Thursday, July 8, 3 p.m. EDT* » In May, consumers probably added $6 billion of debt, after an April rise of $3.9 billion. Strong May auto sales most likely sparked the bigger gain. Even so, consumers may be curbing their appetite for debt. May revolving credit, made up largely of credit-card debt, shrank for a second time in three months.

The *BusinessWeek* production climbed to 219.1 for the week June 19, a 12.1% gain from a yea Before calculation of the four moving average, the index sur 220.7.

BusinessWeek on

For the BW50, more investm data, and the components of the production index visit www.businessweek.com/magazine/e

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The Dangers of Media Mergers

THE MASS MARKET and the mass media once existed in a comfortable symbiosis. Most Americans bought, or aspired to buy, the same few brands of cars, soaps, and soups. The mass media provided the means to promote those brands: television and radio networks, magazines, and newspapers that reached vast swaths of the public simply and efficiently.

No more. The mass market has splintered, and so have the mass media. Now, with an exploding variety of choice, consumers buy precisely what they want—all pitched to them over an almost limitless variety of media outlets, from the Internet to cable channels to specialty magazines (page 60).

Unfortunately, these changes in the structure of the media may pose dangers for democracy. First, media that serve broad audiences are losing ground to niche outlets. Many Americans now communicate only with people who have similar interests and political outlooks. Social scientists have shown that this echo-chamber effect reinforces and amplifies preexisting points of view, making compromise—the essence of a workable democracy—harder than ever to achieve.

Second, as the media business has become tougher, companies have raced to get bigger and diversify into more types of media. Ownership of the media has become concentrated in the hands of a few giants. So while there are more outlets, there are fewer truly independent voices. As the writer A.J. Liebling once observed, "Freedom of the press is guaranteed only to those who own one."

Third, as the mass market dries up, so too does the vertising that supports the newsgathering operations newspapers, magazines, and television stations. The d that more and more "news" will parrot the press relea government, corporations, and lobbyists of the left an

There are more media outlets, but fewer truly independent voices

These are knotty probler Certainly it is neither wise even possible to block the technological advances tha undermined mass-market advertising and permitted s group "narrowcasting." Sti are some things that can be and a federal appeals court Philadelphia recently took a in the right direction. On Ju it slapped down media-own rules devised by the Federa Communications Commiss under Chairman Michael K. Powell as "arbitrary and capricious." That they were. Under certain conditions, FCC's "diversity index" would have allowed a single c to own a daily newspaper, three TV stations, eight radi stations, and a cable system in the same metro area. Th formula disregarded audience size, so a tiny TV station that of Dutchess Community College in upstate New Y would have counted more than *The New York Times*.

Opposition to the FCC rules is widespread. The Sen voted recently to reject them, and they've been opposed broad coalition of groups ranging from the National Organization for Women to the National Rifle Assn.

Ultimately, preserving limits on media ownership sh be part of a broader project to make sure that Americar diverse backgrounds and beliefs can hear, debate, and ultimately understand one another. The health of Ame democracy is at stake.

Stealing a March On the EPA

THE BUSH ADMINISTRATION and the state of California are butting heads over whether carbon dioxide is a pollutant (page 36). This is no semantic game. It goes to the heart of whether the U.S. is ready to get serious about global warming. The Environmental Protection Agency argues that carbon dioxide is not an air pollutant, so the agency has no authority to regulate emissions of it under the Clean Air Act. Detroit, not surprisingly, agrees. One auto-industry lobbyist said last year: "Why would you regulate a pollutant that is an inert gas that is vital to plant photosynthesis and that exhale when they breathe?"

Sure, people exhale a little CO_2. So what? A crushing preponderance of scientific evidence shows that temper have risen sharply in recent decades, and an increase o greenhouse gases—mainly carbon dioxide—is at least partially responsible. Unchecked global warming could sea levels to rise and inundate coastal cities, damage agriculture in equatorial nations, and increase the freq of severe storms and floods.

California gets it. On July 7, its Air Resources Board begin a final draft of rules to cut carbon-dioxide emissio from cars by 30% before 2015. Ordinarily it's not a goo for individual states to meddle with how cars are desig But the Bush Administration courted this potential jurisdictional snafu last August when the EPA, reversin earlier determination, decided that it couldn't regulate dioxide as a pollutant. It's hard to see why a key factor i global warming isn't a pollutant. Instead of fighting in courts, the White House should take a cue from Califor and make global warming a high priority.

July 19

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THE BENEFITS TRAP

Old-line companies have pledged a trillion dollars to retirees. Now they're struggling to compete with new rivals, and many can't pay the bill.

BY NANETTE BYRNES (P. 64)

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Thermostats Electrical transformers High-performance RF/microwave antennas Lighting for **public services** Video cables T
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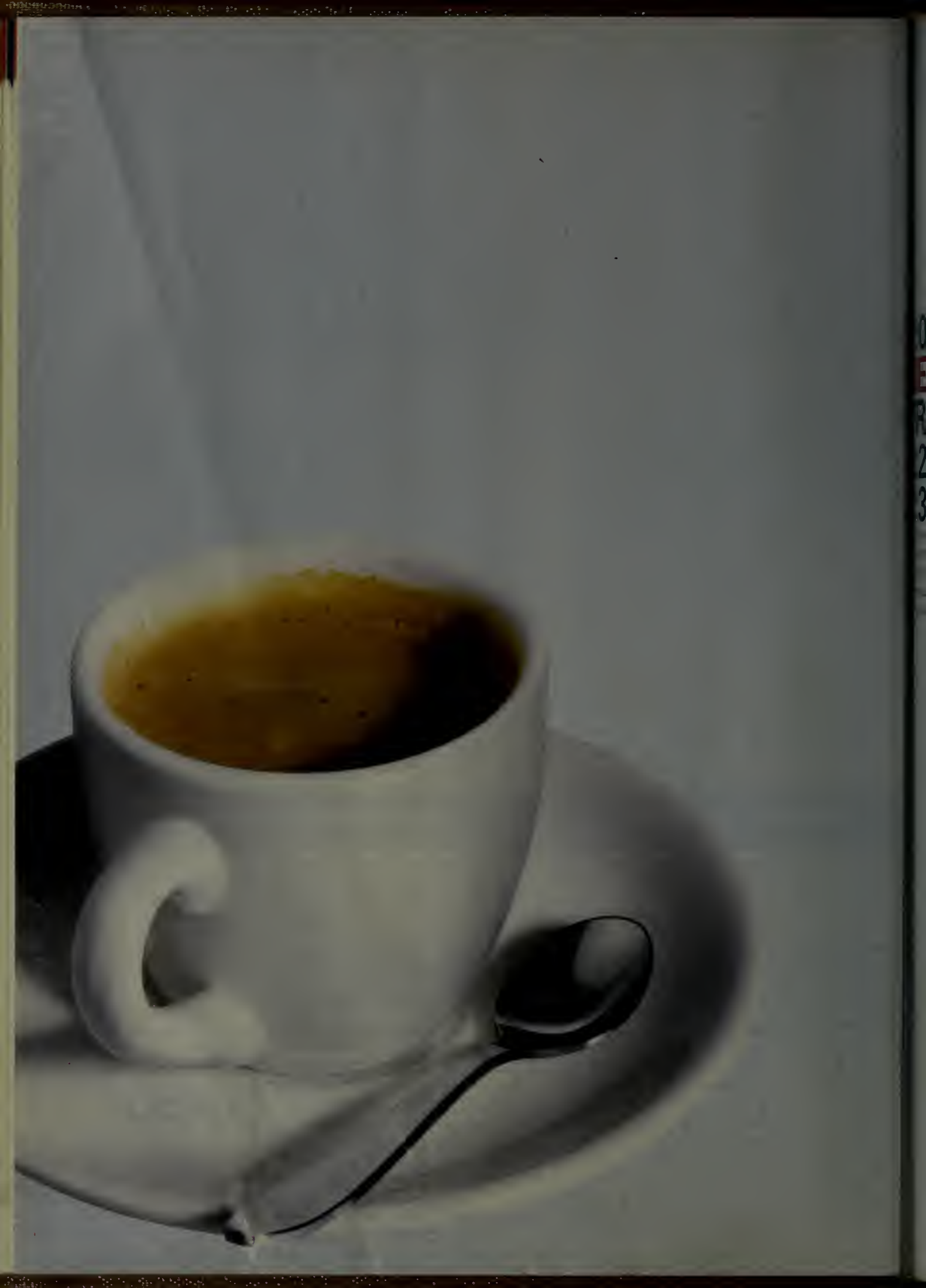

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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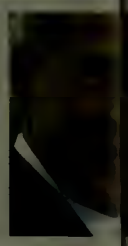
U.S. Foreign Policy: Flexible Or Feckless?



The Bush campaign has made political hay by accusing John Kerry of waffling. But the President has often changed tack on issues from Iraq to the ABM Treaty to North Korea's nukes. Will voters care?

Earnings Could Give Summer Sizzle

Although the market has been lackluster lately, the second-quarter profit picture keeps looking stronger with more companies releasing positive outlooks than negative. That's a good sign for stocks

European Music Fans Are Hearing Apple's Song

iTunes Music Store made a loud debut on the Continent, selling 800,000 songs in its first week. That could help boost iPod sales, but drowning out rivals won't be easy

Wi-Fi Hits the Hinterlands

Who needs DSL or cable? New "mesh" technology is expanc the reach of wireless networks by allowing Net signals to be beamed across miles, turning long-neglected small towns— even recreational-vehicle parks—into broadband hot spots

The Queen of the Bond Market Surveys Her Realm

Joan Payden of investment firm Payden & Rygel talks about the Fed, the debt she likes, Europe, the changing shape of emerging markets, inflation...

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JP Front

"It seems I'm a uniter, not a divider."

–Senator John McCain, on being used in campaign ads for both George Bush and John Kerry

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CAL HERO

)W KEN LAY'S IARITY)ULD PAY OFF

:NNETH LAY ever goes to in Houston, he may have rprising ace up his ve: a pool of sympathetic rs. Although the former **n** chairman is reviled by isands of local citizens lost jobs and money ause of the company's

BIG GIVER Will a Houston jury convict Lay?

vnfall, he is still arded fondly by ny other astonians for mammoth charitable tributions. ndicted on July 7 for his in the debacle, Lay was sionate about turning the ou City into a "world-s" community. His erosity touched almost ry imaginable segment of population. During the 1990s, "he was probably largest single donor" to the Houston branch of the **NAACP** and raised "most of" the $375,000 the group needed to host two national conventions, according to Howard Jefferson, president of the local organization. He also played a critical role in the financing of the city's Holocaust Museum.

Sports fans are grateful for his efforts to build a new baseball stadium. Art lovers applaud his contributions to the Houston Museum of Fine Arts. Sick Texans benefited from the money he showered upon the M.D. **Anderson Cancer Center.** And kids in nearby Katy, Tex., still play T-ball at the Ken Lay **YMCA.** "There's a good chance that you would see a hung jury against Ken Lay," says Houston criminal defense lawyer David Berg. "He was nice to people on the way up, and it is going to be difficult to get people to turn on him on the way down."

Uncooperative jurors have been a thorny problem for white-collar prosecutors. A lone holdout helped to unravel the case against former **Tyco** chieftain Dennis Kozlowski. And jury disagreement torpedoed the first case against investment banker Frank Quattrone—even though prosecutors won a conviction on retrial. While Lay has been knocked off his pedestal, remember this: Defense lawyers have to win over only one juror for a mistrial. *–Mike France*

DRUG WARS

Taking the Cialis Challenge

THE $1.3 BILLION MARKET for erectile dysfunction drugs is, er, hot. It's about to get even hotter, with a new giveaway that the makers of Cialis will launch on July 12, *BusinessWeek* has learned. Already, men can get free trial kits of all three impotence pills—Viagra, Levitra, and Cialis—from a doctor. And in mid-April, **Pfizer** launched its version of a frequent-flier program: Buy six Viagra precriptions and get the seventh free.

Now, **Eli Lilly** and biotech partner **ICOS** will go further: Try Cialis, and if you don't like it, they'll mail you a voucher good for a prescription of Viagra or Levitra. The gimmick has been used in consumer marketing before, but this is believed to be a first for a prescription drug. "We're willing to put our money where our mouth is," says ICOS Chief Executive Paul Clark.

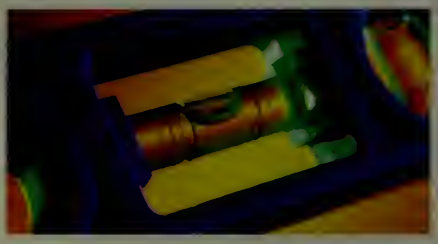
The Cialis partners have crossed boundaries before. They were the first to mention erectile dysfunction explicitly in prime-time TV ads when the drug hit the market earlier this year. That was done to point out that Viagra and Levitra work for four hours, while Cialis is good for up to 36 hours. The aggressiveness seems to be working. Viagra, which created the market, still grabs the bulk of sales. But Cialis is now besting Viagra and Levitra by a 2-to-1 margin in new prescriptions, according to market trackers **IMPACTRx.** What will happen now that satisfaction is guaranteed? *–Michael Arndt*

UP Front

EXECUTIVE SUITE

INSURERS GIVE BOARDS A BREAK

PRICES FOR directors and officers (D&O) insurance finally seem to be leveling off. In fact, companies in industries at lower risk for shareholder lawsuits, such



as health care, may even see rate reductions. The rate-loosening should tamp down the overall D&O premium hike to 20%, according to the **Insurance Information Institute.** That's pretty modest compared with the 102% and 70% jumps in 2002 and 2003, respectively.

What's behind the stabilization? A less volatile stock market and the Sarbanes-Oxley Act's influence on financial reporting have cut the risk of lawsuits. Plus, scores of companies have entered the market, bringing down rates. "D&O [should] continue to fall, or at least level off, in the next 6 to 12 months," says Marc McCabe, a senior vice-president at D&O specialist **Nasdaq Insurance Agency.**

Notable exceptions? The industries most susceptible to litigation—telecom, technology, and financial services—are likely to see rising premiums. And there is still-pending litigation that, if successful, could make lawsuits against directors easier to win. Has the D&O market reached the morning after, or is this just the eye of the storm? *–Brian Hindo*

TOY STORY

LOOK OUT, ELMO: There's a mouse in the house. This Labor Day, Walt Disney will roll Mambo Mickey, a $20 version of the iconic cartoon character. It sings and dances to th Lou Bega hit *Mambo No.5*. If that sounds familiar, it's because Mattel's Fisher-Price u has for two years running had one of the to selling toys with a series of Elmo dolls that the limbo, hokey pokey, and chicken dance. This year, Elmo will swing to the Village Peo *YMCA* (while crooning E-L-M-O). Mambo Mickey will be available only at Disney store and at Target. Elmo's distribution is wider. S it could be paw-to-paw combat in those Tar aisles come Christmas. *—Christopher Palm*

REAL ESTATE

EUROPE'S GOVERNMENT FIRE SALE

ALL ACROSS EUROPE, public housing and other properties are on the block. The city of Berlin recently sold 65,700 flats to **Goldman Sachs** and **Cerberus Capital Management** for $2.4 billion. And France hopes to raise $605 million by selling 10 million square feet of space, including the historic **Ecole Nationale d'Administration** in Paris.

Poland, the Czech Republic, and Russia also are privatizing apartments. Investors like the distressed prices. And with deficits plaguing Europe, more sales may be in store.

–David Fairlamb

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FACE TIME

BRAD SELIGMAN

TAKING ON RETAILING'S BEHEMOTH

When Berkeley (Calif.) lawyer Brad Seligman was asked to take on a sex-discrimination case against Wal-Mart Stores, he had never been inside one. He may not be familiar with what's in the aisles, but he can recite statistics on how many women are store managers (34%, vs. a 56% industry average). On June 22, a federal judge ruled that a lawsuit he filed can proceed as a class action representing 1.6 million former and current female Wal-Mart employees.

Public-interest law is Seligman's family legacy. His dad was a prosecutor at the Nuremberg war-crimes trials. The younger Seligman, 52, has filed 45 class actions, from sex-discrimination to disability-bias claims.

To take on Wal-Mart, he recruited 17 lawyers at 7 firms who have shelled out nearly $2 million in expenses so far. "We knew we'd have to be ready to go all the way to trial," says Seligman.

He needs the help: He must contact 1 million women who are no longer at Wal-Mart. Postage alone may cost $500,000. *–Jessi Hempel*

SILICON CULTURE

A BIG EASY GABFEST WITH MEG

EBAY ENDED its member conference, eBay Live! 2004, on June 26 in New Orleans. More than 10,000 sellers and buyers took classes, traded ideas, and met the online marketplace's staff. Equal parts love fest and bitch session, it's an annual highlight for **eBay** CEO Margaret Whitman, who talked with *BusinessWeek*'s Silicon Valley bureau chief, Robert D. Hof. Here are some excerpts:

Members love to complain. Do you ever get tired of it?
No, not really. Yes, we get a lot of feedback from users. But they're pretty happy. I ran into a woman who said: "I really have to dial up my eBay business because I have a second child going to college, and I am paying both college tuitions out of my eBay business." That's the kind of story that is the essence of this company.

EBAY'S WHITMAN

Some sellers hate the constant changes on the site. How are you responding?
The community has seen a lot of change. We probably need to slow down that pace just a tad. It's hard for folks to adapt to so much change.

Have eBay's sites around the world changed how people buy and sell?
I hear all the time that Germans trade on the Italy site. They may not speak much Italian, but the site is laid out the same way, so they kind of know how to do it. In the long run, the way the works consistently acros geographies is going to b important to global trade

Rumor has it that you mig leave eBay for Walt Disne
(Laughs) As far as I know there isn't a vacancy at Disney. People speculate lot. But I have one of the jobs in Corporate Americ The community of users endlessly interesting and endlessly surprising.

For an extended version, go www.businessweek.com/magazine/extra.htm

PC PATROL

MICROSOFT: THE MOUSE THAT GLOWED

WHILE MICROSOFT has long outrun **Apple** in the marketplace, it has trailed Jobs & Co. when it comes to product design. Now, Microsoft wants to be known for its aesthetics, too. On July 8, it will unveil a computer mouse by French designer Philippe Starck. The $35 mouse is a sleek silver orb with a strip of light—available in blue or orange—down the center.

Is it a case of design trumping function? To make the mouse light up, a cord brings power from the PC. The most popular mice, though, are wireless. But Microsoft believes certain users won't care.

"We're looking to attract people who appreciate design," says Ken Fry, Microsoft's hardware-design director. And maybe even get some style points in the process. *–Jay Greene*

THE STAT

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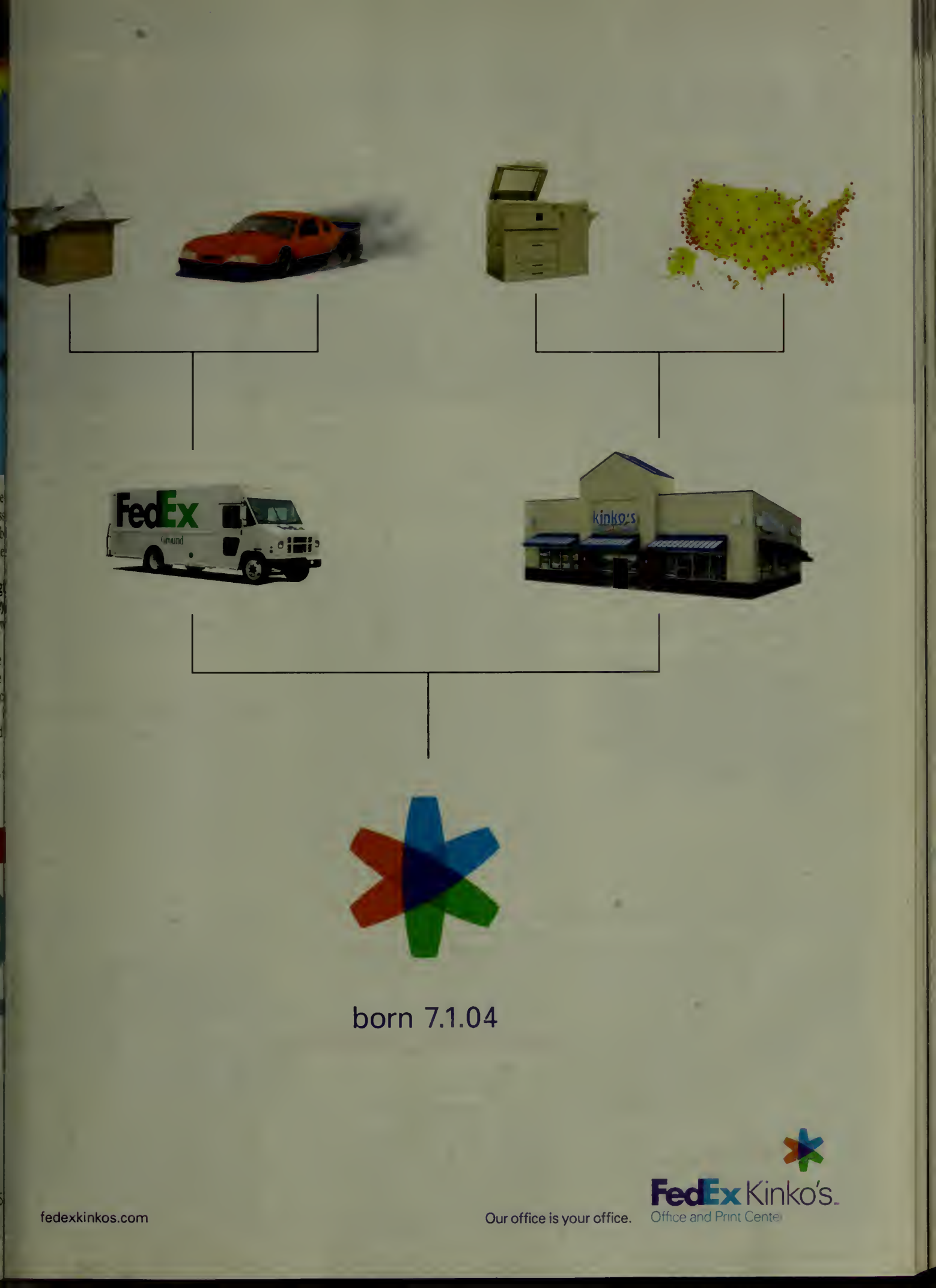
The percentage of internal auditors who have identified various gaps in their companies' accounting controls

Data: Jefferson Wells International survey of 203 auditors, March 2004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VOTING: IT'S THE NUMBERS, NOT THE LOCALE, THAT COUNT

I THOUGHT "Does your vote matter?" (Cover Story, June 14) was generally very thought provoking. I have trouble understanding the logic of some of the letters in reply. (Readers Report, July 5).

Darel J. Coterel of Prattville, Ala., wrote in support of the Electoral College, pointing out that Al Gore's win was largely based on vote totals in California and New York and in a big part, from—horrors—Los Angeles and New York City. "There is no way I want the values of two major cities to dictate national policy to the rest of the nation," Coterel wrote. All well and good, but who does Coterel believe should dictate national policy? Casper, Wyo.? Charleston, S.C.? Appleton, Wis.? Perhaps Prattville, Ala.? I'm puzzled why voters in those and any other U.S. cities should have any more right to "dictate policy" than those in Los Angeles and New York.

Reader Doug Boehler of Bangor, Pa., tells us we need the Electoral College because otherwise we'd have mob rule, Boehler certainly knows what that me "If the popular vote of the 'mob' electe President, New York and California w always elect a President for the w country," Boehler pronounces. I wo how Boehler's "mob rule" theory w have worked in the 1976 election, w New York went for Jimmy Carter and ifornia for Gerald Ford, and also 1 when California went to George I Bush and New York to Michael Duk Kind of blows the theory when the states don't always vote the same way

We in Pennsylvania, with a popula of something over 12 million, have U.S. senators. The five smallest states, a combined population less than have a total of 10 senators. Add in York, and we get a staggering four s tors for 30 million people. (California even fewer for its 30 million-plus.) S we get more votes in the House, but House doesn't pass bills by itself. Sm states also get a higher percentage of E toral College votes, compared with Pe sylvania, than their populations justif

I'm really in no hurry to change Constitution, but please spare those o in the dreaded "elitist" East that rhet about votes counting less in small sta

–David Thom
Waynesboro,

CORRECTIONS & CLARIFICATIONS

In a table accompanying "The vanishing mass market," (Cover Story, July 12) the name of Coca-Cola Co. marketing executive Katie Bayne was misspelled.

"Oil's rise will lift Suncor" (Inside Wall Street, June 28) on Suncor Energy Inc. should have read, "Canada's oil sands deposits in Alberta [and not Suncor's] contain estimated reserves of 175 billion barrels—second only to Saudi Arabia."

"The lobbyists' tax bill" (Editorials, June 28) incorrectly listed Oregon as a state with no income tax. Oregon has an income tax but no sales tax.

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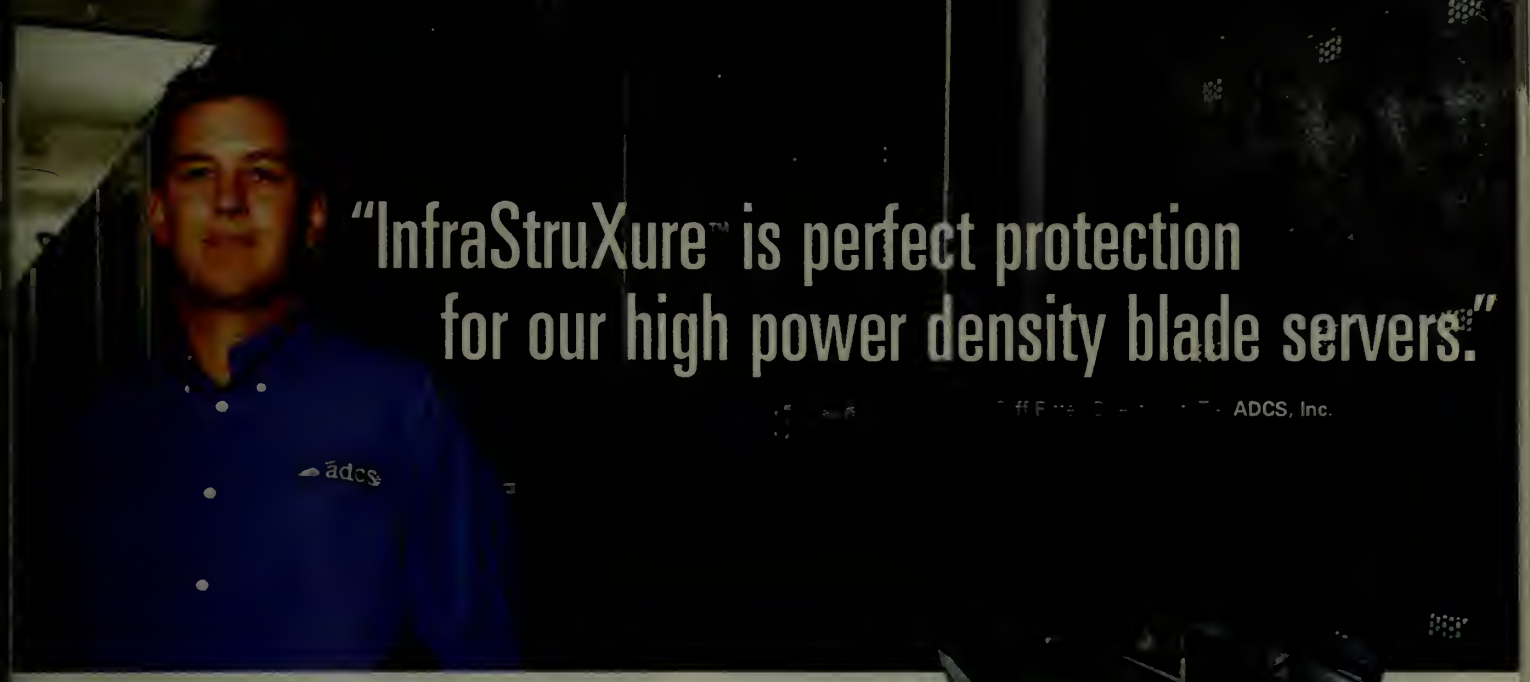

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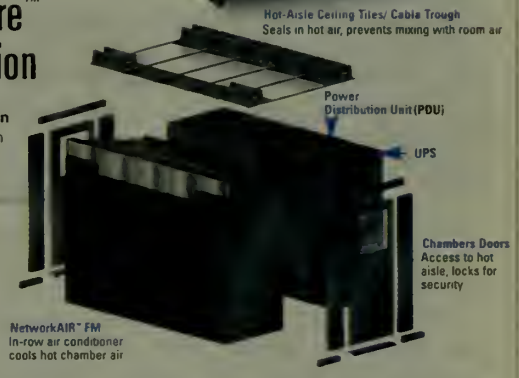

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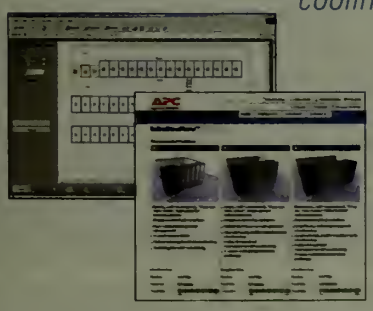

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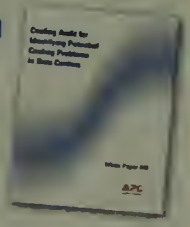

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CELEBRATING 75

As part of its anniversary celebration, BusinessWeek *is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. In late September, 2004,* BusinessWeek *will publish a special commemorative issue on Innovation.*

Cracking the Code of Life

JAMES WATSON AND Francis Crick transformed biology with their 1953 discovery of the molecular structure of deoxyribonucleic acid—DNA—the building block of all life. Their double-helix model cracked the code for how genetic information is passed from an organism to its offspring, laying the groundwork for the biotech industry, the Human Genome Project, and the first cloned animals. But the story of the double helix is about more than the mind-meld of two brilliant scientists. Cold War hysteria and male chauvinism also played a part.

Neither man started out as a biologist. Watson, an American, was a zoologist, while Crick, from England, started as a physicist. By 1951, both had switched to the emerging field of molecular biology and landed at Cavendish Laboratory in Cambridge, England.

Watson, then 23, and Crick, 35, were both brash, arrogant, and fiercely competitive. They decided to team up within a half hour of meeting each other in order to solve one of the key problems in biology at that time: the structure of DNA. the end of the 1940s scientists had discovered that DNA contained an organism's entire genetic blueprint. But it wa not known how this seemingly simple substance—made up primarily of four key molecules—could encode so much complex information. Watson and Crick spent all their waking hours on the question, driven by fear that they wou be beaten to the solution by the famous American chemist Linus Pauling. But the age of McCarthyism bought them time. Pauling was about to board a plane to England in Ma 1952, to seek access to some highly detailed X-rays of DNA King's College London, when the U.S. government seized h passport, citing his "un-American" antiwar activities.

The Cold War and male chauvinism played roles in solving the DNA riddle

The X-ray images were created by Maurice Wilkins a Rosalind Franklin. These tw scientists also hoped to crack the code, but their mutual dislike stymied their collaboration. Franklin, one o the few women scientists at Kings, was ostracized to the point where she decided to leave. Wilkins showed Watso one of Franklin's clearest DN X-rays—without her permission—and it was the eureka moment: Watson realized that the cross-shaped patterns in the photo meant DNA had to be shaped like a helix. He and Crick built a metal mod of two helixes held together by pairs of the four molecules. Their report on the model, in the Apr. 2 1953 issue of *Nature*, won Watson and Crick, along with Wilkins, the Nobel prize for medicine in 1962. Franklin, largely unheralded, died of cancer in 195

Watson and Crick continue to do groundbreakin genetic research. Watson has long been head of the Cold Spring Harbor Laboratory on Long Island, N. which focuses on genetics, and he was a driving fo behind the Human Genome Project. Crick conduct genetic research into the brain at the Salk Institute Biological Studies in San Diego. "Rather than belie that Watson and Crick made the DNA structure, I would rather stress that the structure made Watso and Crick," Crick wrote in a 1974 *Nature* article. "B what is really overlooked...is the intrinsic beauty of the double helix." ■

–By Catherine A

MIND-MELD James Watson and Francis Crick

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BY STEPHEN H. WILDSTROM

Why It's Hard Making Text Easy to Read

A recent column on flat-panel monitors prompted letters from a number of readers asking what they could do about type that appears too small on their displays. I wish there were a simple answer to this 20-year-old problem, but there isn't. There are, however, several tricks that can make inscrutable text a lot easier to read.

The basic problem is the stupid way computers determine type size. Windows and other operating systems interpret the font size you select as a fixed number of pixels, but the size of the pixels varies with screen size and resolution. Software generally assumes about 100 pixels per inch, but some monitors display double that—cutting the height of type by 50%. Microsoft promises that the next version of Windows, due in a couple of years, will match type size to what the display actually shows, but I'm not holding my breath.

The Windows Display control panel gives you a font-size option that seems to offer a solution. But changing this setting only affects icon labels, the size of menus, and other "system" text. It has no effect on word-processing documents, e-mail, or Web pages. Many programs provide their own adjustments, but there's no consistency in how they work. Here are tips for some popular Windows programs. (Macs pose similar problems, and often the adjustments for various applications are similar to their Windows counterparts.)

It's easy to get a proper font display in Microsoft Word and Excel. Many people err by choosing a font size that looks good on the screen, but this is a mistake. Ten-point or 12-point type is standard for most printed documents, and anything big enough to look good on a screen may look awful on paper. The right way to control the size of displayed text is with the "zoom" setting found on the standard toolbar. Zoom can be set between 10% and 500% of normal, so you can choose a setting that is comfortable to read on any display without affecting the appearance of a printout.

THINGS GET UGLY FAST IN OTHER PROGRAMS. Outlook is a particular nightmare because the method for controlling the display of text varies, depending on whether you are composing or reading your mail. The former is fairly simple: Recent versions of Outlook use Word as an editor, and the zoom tool works just as it does in Word. The display of received mail depends on how the sender formatted it. If it was sent as "plain text," the size is determined by your setting for composing outgoing messa The display of other messages depend the fonts chosen by the sender. If the message was sent as "HTML" or "rich text," the View menu gives you some limited ability to enlarge or shrink the But the settings work only on message that you double-clicked to open in thei own windows, not those shown in the preview pane. The simpler Outlook Ex is more tractable. The View menu give choice of five sizes for both reading an composing. Unlike Outlook, the choice works for all types of mail.

Trouble is, different programs fix the problem in different ways

Internet Explorer and oth browsers also have problems theory, you can pick from a r of sizes on the View menu. B because of the way many We sites are designed, selecting larger size may simply chang the spacing between the line have no effect at all.

The next Windows release code-named Longhorn, is supposed to fix the underlyin difficulty. The software will s the resolution of the display and scale fonts, icons, and ot display elements so that they appear the proper size on a screen. But I don't expect to see Longhorn for at least tw years. And it's not certain that the scaling feature will ma the final cut or that it will work on any but the newest an most powerful computers.

So for the time being, we are left with a collection of application-specific tricks. They are a nuisance to learn, b the effort is worth the trouble. You eyes will thank you. ■

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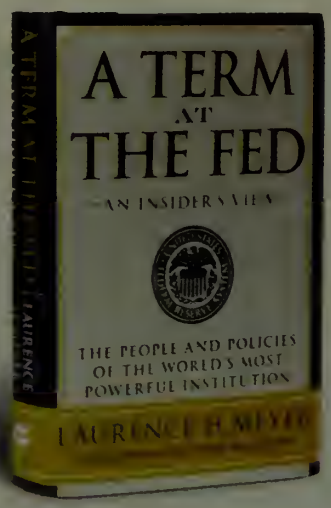
In Greenspan's Shadow

A TERM AT THE FED An Insider's View
By Laurence H. Meyer; HarperBusiness; 264pp; $26.95

For much of the late 1990s, then-Federal Reserve Governor Laurence H. Meyer was on the wrong side of the argument over the New Economy. He was skeptical of Fed Chairman Alan Greenspan's claim that the U.S. had entered an era of productivity-powered prosperity. And he wasn't shy about saying so, stressing in speeches and in testimony to Congress the limits to economic growth and the risks of faster inflation.

In his new book, *A Term at the Fed: An Insider's View*, Meyer displays that same sort of frankness in discussing his performance as a central-bank policymaker from 1996 to 2002. He's candid about the mistakes he made, admitting that he was late in recognizing the productivity revolution and ruing the fact that he—and the Fed—didn't pay more attention to the developing stock-market bubble. Meyer, who's now at the Center for Strategic & International Studies, a Washington think tank, even wonders whether he had any real influence on interest rates at the Fed, given the large sway Greenspan has at the central bank.



Promoted as a behind-the-scenes look at "the people and policies of the world's most powerful institution," this clearly written book is better at dissecting the terms of the economic debate than providing insights into Fed personalities. Indeed, in the final chapter, entitled "Alan, I hardly knew you," Meyer confesses that, despite his 5½-year membership on the Fed board, he was barely acquainted with Greenspan on a personal level. In general, says Meyer, Fed governors kept to themselves, and Greenspan savored "his distance from the rest of us." While Meyer respects Greenspan as a person and a policymaker, he acknowledges that he was frustrated by the chairman's "disproportionate power" over interest rates.

Meyer never offers a comprehensive critique of Greenspan's leadership style—a surprising shortcoming given how he felt about the chairman's predominance. But the book is peppered with insights into how Greenspan exercises his influence. We learn that prior to each meeting of the policymaking Federal Open Market Committee (FOMC), which includes regional Fed bank presidents as well as central bank governors, Greenspan would meet colleagues in Washington to lay out his views and line up their implicit support for his predetermined positions. That ensured that he was never voted down at the FOMC meeting.

Before the meeting, Greenspan would also draw up the statement on the economy and monetary policy that the committee would issue after its gathering. "The fact that t statements were prepared by the chairman, without any re input from the committee, created a degree of tension...th never diminished during my term," Meyer says. That fricti continued until recently, with Greenspan agreeing in the p few months to distribute different versions of key parts of t statement beforehand for the comments of others.

Greenspan's finest hour undoubtedly came during the l 1990s, when he successfully resisted calls from Meyer and others at the Fed to raise rates and rein in the New Econon At each meeting, the Fed chief would acknowledge the cas for higher rates but suggest that an increase be put off unt the FOMC's next gathering. When that meeting rolled arou Greenspan would repeat the pattern. Meye doesn't think this was a deliberate strategy delay, just that Greenspan was waiting for signs of inflation to appear. Yet the monetar maestro never let himself be pinned down c how fast he thought the economy could gro or how far unemployment could fall before generating inflation, further frustrating Me

The author also discusses what he calls t Fed's "signal corps"—the chairman's use o speeches, congressional testimony, and eve talks with reporters to hint at upcoming rat changes. The author suggests that the approach could have forced the FOMC to accept preordained decisions, but Meyer st short of saying that that ever occurred.

The book excels at setting out the econor challenges the Fed faced dur Meyer's tenure, including the Asian financial crisis, the end the U.S. stock-market bubble and finally, the September 11 attacks. There are also some felicitous turns of phrase: At one point, Meyer depicts his differences with Greenspan a debate between those, like himself, who thought the U.S was enjoying a run of good luck—"temporary bliss"—and the chairman's view of the "permanent bliss" of higher productivity. And throughout, Meyer displays a refreshing sense of humor about himself. a profile one journalist described as "gushy," Meyer says: "Gushy? I just thought [it] captured the real essence of me

The author offers a peek at how the Fed chairman wields clout

As a Fed policymaker, Meyer experienced some of the m exhilarating—and frightening—of economic times the U.S. has faced. While the book is not without flaws, it is a welco addition to the history of the past decade. ■

–By Rich Mi

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)on't Be Spooked by ;orry-Looking Stats

spite recent weak reports, growth should still hit 4% in the second half

U.S. ECONOMY If you took off for the beach or some other vacation ɔt before the July 4 weekend thinking the economy was in great ape, you returned to some unsettling news. The June labor markets ɔked downright weak. Big retailers such as Wal-Mart Stores Inc. d Target Corp. reported disappointing results last month, and June ales tanked. Has the recovery hit a wall, dimming pects for sales, output, and jobs in the second half?) be sure, second-quarter economic growth probably ɔelow expectations put forth just a few weeks ago. ıomists have marked down, some by a percentage t, their previous average projection of a 4.4% gain in quarter's real gross domestic product. The Commerce t. will report the official number on July 30.

would be shortsighted, however, to extrapolate the nt weakness into your expectations for the second Most likely, higher prices for gasoline and other gy products, which caused the consumer price index se at a 5.1% annual rate so far this year, finally began ıaw at household buying power. That explains the retail reports.

ut by early July, the average price for regular gasoline fallen for six weeks in a row, from $2.06 per gallon to 0, suggesting some moderation in the overall CPI this mer. The danger, of course, is a resurgence in oil es. Crude prices topped out at more than $42 per el in late May and fell to below $36 by late June, but ıly 7, they were back up to just over $39 on fears of ɔly disruptions. Still, unless crude prices surge anew, ıper gasoline will help restore some of the lost sehold purchasing power, enabling spending to ɔund in the second half.

ı addition, after slowing in the second quarter, ness outlays for equipment are likely to speed up as panies take advantage of the depreciation allowances are scheduled to expire at yearend. Production, sales, payrolls will also get a lift from businesses' efforts to ɔck their current inadequate levels of inventories. rue, growth in the second half of 2004 won't look as ıst as that of the second half of 2003, when tax cuts ed a 6.1% surge. But the economy has the supports it ls to grow at a 4% pace in the next two quarters.

AT, THEN, TO MAKE OF June's soft employment ɔrt? Clearly, the gain of just 112,000 new nonfarm jobs a head-turner after the economy averaged 304,000 in previous three months. Plus, the average workweek ɔped 12 minutes, to 33.6 hours. And the percentage of stries adding workers fell to 57%, from May's 64.6%.

But the Labor Dept.'s jobs report runs counter to other more upbeat data, while some of the June softness can be explained by noneconomic events. First, new claims for unemployment insurance continue to average under 350,000 per week—a level that, in the past, has coincided with job gains well above June's slim increase.

Second, Labor's survey of businesses occurred during the week that included the national day of mourning for President Ronald Reagan, when some businesses closed. That may have caused part of last month's steep decline in hours worked, which had been in a clear uptrend. In particular, the factory workweek slipped by 18 minutes, to 40.8 hours, even though the pace of factory output has picked up in recent months.

Third, the June job report is strikingly at odds with the views of purchasing managers at both manufacturing and nonmanufacturing companies. The Institute for Supply Management's measures of activity in both sectors fell from their May readings but stayed at elevated levels. The ISM's factory index is close to a 20-year high.

Most important, the ISM's index of manufacturing employment dipped only slightly from its 30-year high in May, and its index of employment in nonmanufacturing industries rose to the highest level in the seven years of record-keeping (chart). By contrast, the government data showed factory payrolls falling by 11,000, after four monthly gains in a row, and only a 122,000 rise in service-sector jobs, the smallest since February. Even service industries that are known to be strong right now, such as health care and finance, posted smaller job increases than in recent months.

THE ANOMALIES DON'T STOP THERE. Construction payrolls did not grow in June, even though starts of single-family homes in May continued to rise, and sales

of new homes hit a record. Also, construction spending continued to climb in May, and the high level of activity will support further outlays in coming months. As a result, construction employment is likely to rebound.

Even with June's small gain, payrolls so far this year are growing at an average clip of 211,000 jobs per month. Hiring could easily sustain that pace in the second half. For example, that rate would be consistent with the economy growing about 4% and with productivity gains slowing to about 2%, a reasonable second-half scenario.

In addition, it's worth noting that the growth rate of payroll jobs measured by the Labor Dept.'s survey of businesses has now come back into line with Labor's data on jobs calculated from its survey of households. Previously in this recovery, the household measure had outperformed the payroll tally. Now the two gauges show yearly job growth at nearly the same pace (chart).

What's interesting is that the payroll data have adjusted upward to meet the household data, suggesting that the household survey late last year may have been giving the better signal on job growth. In June, the household survey showed a solid job increase of 259,000, with the jobless rate holding at a 2½-year low of 5.6%.

EMPLOYMENT GAINS in coming months are likely to recover some of the weakness seen in June. But the loss to second-quarter household incomes from higher inflation will not be recouped as quickly. Because of the jump in energy costs, higher inflation has offset much of the 7.2% gain in wages and salaries, and it has taken away a big chunk from household buying power.

In fact, June hourly earnings of production worker who comprise about four-fifths of private payrolls, we up 2% from the year before. But surging prices mean wages of production workers are now falling for the f time in nine years. Economists at Morgan Stanley estimate that the run in energy prices from December to May cut spending power by roughly $50 billion.

CLOSING THE GAP IN THE JOB DATA

Data: Labor Dept., Global Insight Inc.

Because of that "ta on consumers, real personal spending probably grew at an annual rate of less th 3% last quarter, well below the 4.3% pace the previous four quarters. A slowdow consumer outlays is one key reason for the downwar marks to second-quarter real GDP growth.

But those revisions don't automatically mean seco half prospects should be marked down as well. Stead and income growth, along with more capital investm by businesses and some inventory rebuilding, will ve likely provide the demand needed to keep this econo growing at a pace of at least 4% through the end of t year. It would be a mistake to write off this recovery j because of one month of sorry-looking data. ■

INDIA

Inflation Will Take a Toll on Growth

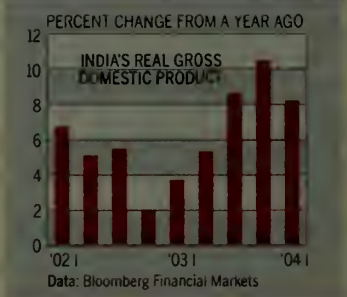
INDIA'S ECONOMY came roaring back last year. In the fiscal year ended this March, growth hit a 15-year high. But a repeat performance is unlikely if inflation accelerates and the government can't rein in its budget deficit.

In the first three months of 2004, real gross domestic product grew by 8.2% from the year before (chart). Agricultural output was up 10.5% as farmers continue to reap the benefits of last year's good monsoon season, following three rain-starved years. Industrial output also accelerated in the period.

As long as rainfall is at least normal this year, farmers should do well again. And since a majority of the country's workforce is still involved in agriculture, another good harvest will keep domestic demand going. Low interest rates and increased demand at home and abroad are expected to raise factory output and fuel capital investment. Overall, the government expects real GDP to expand by 7% to 8% this fiscal year.

Private economists, however, see growth coming in nearer to 6.5%. One reason is inflation. The widely watched weekly wholesale price index for the week ended June 19 rose 5.9% from the year before. A rate above 6% now looks likely. The government pushed up gas prices by 6% in June, and further hikes are possible if crude prices remain high. The weakening currency is hurting the economy: The rupee fallen 6% in the past two months

AN UNSUSTAINABLE PACE



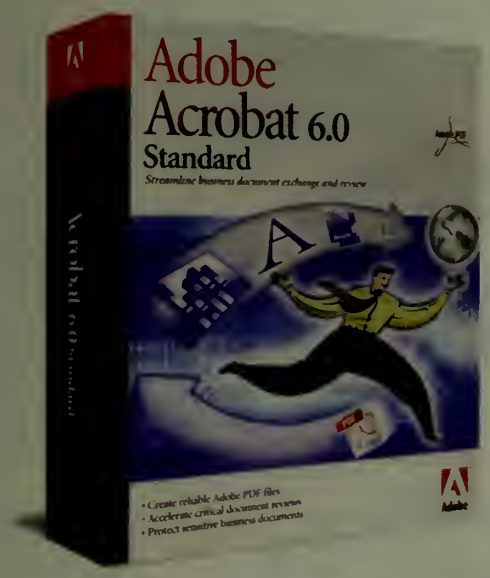
Data: Bloomberg Financial Markets

Higher inflation could force th Reserve Bank of India, which exp prices to rise 5% this fiscal year, t its key policy rate from a decades 6%. A rate hike, possibly as early the RBI's next policy meeting in October, would crimp the nascen capital spending upturn.

Despite a law mandating the government to trim its budget de by at least 0.3% of GDP, economi see the gap rising to 5% or more, from 4.6% last fiscal year. Tax revenues are currently above ye ago levels, but the Indian Nation Congress party, elected in May, wants to lift social spending. Plu government coffers will feel the pinch from the planned slowdow in privatizing state-owned businesses. ■

–By James Mehring in New

Creation vs. Evolution



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CORPORATE FINANCE

STUFFED WITH DOUGH

Profits are up, but battle-scarred companies keep loading up on cash. Will their caution hurt the economy?

BLESSED WITH A LOCK ON its markets, Microsoft Corp. is one of the greatest cash machines ever created. At the end of March, it had $56.4 billion of cash on its books. And that figure could swell to nearly $60 billion when it reports its fiscal fourth-quarter earnings on July 22. That may be too much for even Microsoft's conservative chairman, William H. Gates III. With its long-running antitrust troubles finally winding down, Microsoft is expected to announce by the end of July a share buyback that some suspect could be as high as $40 billion.

When it comes to its corporate piggy bank, Microsoft is in a league of its own. But many other companies, flush with soaring profits, are also facing an embarrassment of riches. At the end of the first quarter, the 374 industrial companies in the Standard & Poor's 500-stock index collectively were sitting on $555.6 billion of cash and short-term investments. That's up some $56 billion, or 11%, since the end of 2003, and more than double what they had at the end of 1999.

PUNY RETURNS

THIS GROWING MONEY pile could spell either opportunity or trouble for the economy and investors, depending on what companies decide to do. With the rise in consumer spending slowing, the economy needs companies to start tossing some of those big bucks around to keep momentum from flagging. That could happen as CEOs' moods brighten. The Conference Board reported July 7 that more than 90% of chief executiv its latest quarterly poll say the ecor has improved. If the corporate d start flowing, "there is yet another sh drop in the expansion," Federal Re Chairman Alan Greenspan recently the Senate Banking Committee.

But, so far at least, instead of putti this firepower to work—by pumpin capital budgets, upping the pace of h restocking inventories, or passing ou ger dividends—companies are ke much of their powder dry. Rather tha ing a risk, many would rather park cash in the equivalent of money-m funds—never mind that they're often ing a puny 1% return. The mood is c "continued caution and disciplined s ing in the business sector," conclu number of members of the Fed's p

IN THIS SECTION:

4 Kerry's task now: Wowing voters

35 Is there a housing bubble?

38 Those disappearing food brands

40 Why Apple needs to shine up iMac

making Open Market Committee at its May 4 meeting. "That caution," adds Sung Won Sohn, Wells Fargo & Co.'s chief economist, "is holding back economic growth."

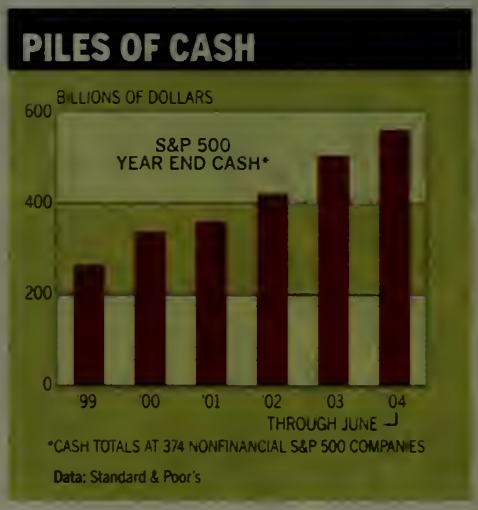
Why aren't companies spending more? Blame it on the series of events that knocked them for a loop over the past few years: recession, terrorist attacks, financial scandals. After getting pummeled, companies slashed expenditures and set out to boost their reserves. Now, with the economy rebounding, this budgetary discipline is generating a huge surge in earnings. Collective earnings for the S&P 500 reached a record annual pace of $481.7 billion in the first quarter, and equity analysts predict the record will be smashed as second-quarter earnings are reported in the coming weeks.

So far, though, companies have been unusually tightfisted with their new-won wealth. Take capital spending. To be sure, it is rising. But since the start of 2003, it has lagged far behind surging cash flows, something that hasn't happened since the mid-'70s. Similarly, companies aren't restocking their shelves anywhere near fast enough to keep pace with sales. That drove the ratio of inventories to sales to a record low of 1.3 in April.

And after a hiring binge in early spring, employers pulled back and added just 112,000 jobs in June, less than half the 250,000 that had been projected. Despite the tech recovery, Cisco Systems Inc. hired all of 200 employees last quarter—hardly enough to register on the radar screen of a giant that employs 34,000. BellSouth Corp., which slashed 17,000 jobs over the past three years, has cut 2,200 more this year.

All this has produced mountains of cash. In fact, 24 of the 374 industrials in the S&P 500 have at least $5 billion on hand. Many are tech companies, such as Hewlett-Packard, Intel, Cisco Systems, IBM, and Oracle. But other industries have lots of dough, too. High oil and gas prices have pushed Exxon Mobil Corp.'s cash reserves to $15.9 billion, second only to Microsoft. Health-care insurers and big drugmakers also have the Midas touch.

While many execs argue they need the money in case the economy softens or for strategic moves such as acquisitions, the problem with sitting on so much cash is that it drags down a company's return on capital. Anthony J. Carfang, partner at Treasury Strategies Inc., which advises



businesses on cash management, says he has seen "a huge swing of corporate assets into money-market mutual funds," yielding less than 1%.

That's fueling a growing debate about when and what Corporate America will do with this money. Companies have two basic alternatives. They can deploy the cash to fuel growth, by stepping up capital spending, hiring more workers, and acquiring other companies. Or they can return some of this cash to investors, through higher dividends or by stock repurchases.

SECURITY BLANKET

MICROSOFT MAY BE THE FIRST to break the logjam in a big way. Preparing for an imminent announcement on what he'll do with all of Microsoft's billions, CFO John G. Connors says he has been talking to "lots of other companies, bankers, and academics." The likely outcome, says Goldman, Sachs & Co. analyst Rick Sherlund: a massive stock buyback of up to $40 billion. "I hear them talking a lot about being tired of the stock at this level," he

Other cash-rich companies are p ning acquisitions. Health insurer Ant Inc., for one, is wrapping up its $16.4 lion purchase of rival WellPoint He Networks Inc. and is mulling more d with the $16 billion in cash the comb company will have on hand. "We cor ue to be opportunistic," says Ant Chief Financial Officer Michael L. Sn

No one is more aggressive than I South and SBC Communications which are scrambling to finance the p chase of AT&T Wireless Services by gular Wireless, which they jointly o Neither has enough cash to fully fund $41 billion deal. So SBC has been sel off assets, including a large stake in D ish phone company TDC, while BellSo is planning to increase its debt.

But such bold deals are still the ex tion. Although mergers-and-acquisiti activity is picking up, "we don't s frenzied environment in the near futu says Robert Filek, a partner in Price terhouseCoopers' transaction serv practice. "The risk of doing a bad tr action far outweighs the desire to ach a short-term improvement in return."

A similar caution continues to imp what should be a far stronger surg capital spending at this point in the covery. "There's still a negative conn tion associated with overinvestment, that's depressing the rate of ca spending," says James W. Paulsen, c investment strategist for Wells Ca Management. ExxonMobil Chairman R. Raymond recently said he'll hold c tal spending to around $15.5 billion the next couple of years.

True, many economists expect com nies will loosen their purse strings as economy grows. A July 7 report from National Association for Business E nomics notes that 41% of member c panies plan to boost hiring in the next months, up from 34% in April. But w 61% expect to hike cap-ex, just 13% f see increases of more than 10%.

In this environment, some Wall St

Sitting On Big Bucks

Top Ten S&P 500 cash holders*, in billions of dollars

MICROSOFT	EXXON MOBIL	HEWLETT-PACKARD	PFIZER	INTEL
56.4	15.9	15.0	14.0	13.1
JOHNSON & JOHNSON	CISCO SYSTEMS	WELLPOINT HEALTH	IBM	MOTOROLA
10.4	8.9	8.7	8.5	8.4

*Industrial companies

Data: Standard &

tegists say it makes sense for many panies to return more cash to in- ors. Among cash-fat drugmakers, for nple, "you have executives in a ma- industry pretending they are growth nagers," says analyst Richard T. Evans anford C. Bernstein & Co. "The reali- ty is that there are not going to be as many opportunities to deploy that cash as the industry appears to be betting."

During the boom of the late '90s, the mantra was "Cash is trash." Now cash is one of the few security blankets for wary CFOs. But if renewed respect for cash makes execs feel more secure, it's hardly the best news for the economy. ■

–By William C. Symonds in Boston, with Jay Greene in Seattle, Rich Miller in Washington, Peter Burrows in San Mateo, Calif., Joseph Weber in Chicago, and bureau reports

OMMENTARY

STEVE HAMM

Microsoft's Worst Enemy: Success

nless it can reinvent itself, the giant is destined to be–gasp!–a mature company

THE MEMO that Microsoft Chief Executive Steve Ballmer recently sent to the company's 57,000 employees was clearly designed to rally the troops—to get them cited about their jobs and Microsoft's fu- re. But what comes through loudest and earest in the 4,900-word e-mail is quite a ferent message: This is no longer the vi- , nimble, fast-growing Microsoft of yore.

Microsoft Corp. is stuck in a full-blown llife crisis. The 24-year-old company is v a sprawling organization with dozens of inesses, modest revenue growth, and a stock price. Instead of being driven to nge the world—the mission its best em- yees signed up for—a key focus now for lmer is "process excellence," which ms unlikely to inspire Microsoftees to y up all night creating the Next Big ng. The only news in Ballmer's missive s that he's targeting $1 billion in cost cuts he next fiscal year, despite the company's 5 billion cash hoard. "It sounds like a mo that maybe Procter & Gamble would d to its employees—not the kind of thing 'd expect from a dynamic software company," says chael A. Cusumano, a professor at Massachusetts Institute Technology's Sloan School of Management.

BALLMER A soul-searching memo

ndeed, Ballmer's memo pales in comparison with Chair- n William H. Gates III's rousing "Internet Tidal Wave" ssage in 1995. Gates warned Microsoft had to learn to ride Internet wave or risk being left behind. Sure enough, es hung ten. In a way, Ballmer has a far more difficult task. It's Microsoft's very success that has brought on its malaise. The company so thoroughly dominates that it's hard for it to grow much faster than the computer industry. So Microsoft's biggest challenge isn't some external opportunity or threat. It's Microsoft.

What the company needs is a new vision of itself—one that motivates employees, excites investors, and places it once again in the vanguard of an industry on the march. Sure, with $300,000 in annual expenses per employee, it could use some cost-cutting. And it's about time Microsoft distributed a chunk of its cash to shareholders. But neither of those moves would do anything to restore the company's vitality—the excitement that pushed its stock price up more than 10,000% in the 1990s.

Innovation is the key—Ballmer says as much in his memo. But in spite of spending more than $4 billion per year on research and development, Microsoft can't seem to beat its rap: It's a follower, not a leader. After all, it was Google Inc. that reinvented Internet search with its breakthrough technology and Apple Computer Inc. that led the music industry into the Digital Age. You hear about wonderful things in Microsoft's lab. One project, called News Junkie, sifts through articles on the Web and presents to you only the ones you haven't seen before Yet when it comes to actually delivering jazzy new products, Microsoft is often stuck—trapped by its legacy. It focuses slavishly on bolstering the Windows and Office monopolies through what it calls "integration innovation." As a result, it fails to deliver breakthrough innovations that might draw buyers into the stores and get the company growing more rapidly again.

Does Microsoft's midlife struggle signal that the glory days are over for tech? Not a bit. While industry revenue growth is slowing, there's still plenty of innovating to do. Microsoft just has to figure out a better way of going about it. ■

ELECTION 2004

NOW IT'S SHOWTIME FOR JOHN KERRY

He has money and a popular veep pick, but he still hasn't wowed voters

THE INSTANT REVIEWS are in. Voters have given Democratic Presidential candidate John Kerry high marks for picking charismatic first-term North Carolina Senator John Edwards as his running mate. In a matter of hours, a dead-even contest was transformed into a 49% to 41% Kerry lead over President Bush, according to a July 6 NBC News Poll.

The veep bump is welcome news to Democrats who have been frustrated for months at their plodding standard-bearer's inability to pull ahead of a struggling incumbent. Kerry now is in a strong position against a sitting President as the July 26-29 Democratic National Convention nears. Most Americans tell pollsters that Bush doesn't deserve a second term amid the violence of a troubled Iraq occupation and the pocketbook pain of an uneven economic recovery. Kerry's military record has helped insulate him from the traditional GOP "weak on defense" assault. And he has raised far more money than any Democrat before him, turning what once looked like a 3-to-1 GOP cash advantage into something closer to a more manageable 2-to-1 difference—or perhaps even a draw, if union expenditures and liberal "527" groups are taken into account.

Perhaps most important, Kerry has made deep inroads with the swing voters who will determine what is shaping up to be another close election. A July 1-3 American Research Group Inc. poll showed Kerry leading Bush among independents, 50% to 39%, with 4% going to Ralph Nader. While Kerry may yet bear down further on this bloc, just 4 in 10 independents believe Bush is doing a good job.

SUNSHINE BOYS Edwards' optimism could prove infectious

SOARING ON THE STUMP

KERRY'S VICE-PRESIDENTIAL pick, a stem-winding Southerner whose populist stump style could help Dems with blue-collar workers, seems like another plus. During his short-lived Presiden bid, Edwards electrified crowds with laments about the inequities of "t Americas" and Clinton-like tales of ing by his bootstraps from mill work son to successful trial lawyer. Despit consistently liberal Senate voting reco Edwards scored well in the primar with conservative Democrats, indepe ents, and even moderate Republica "Edwards has Clintonian appeal," s Al From, chief executive of the cent Democratic Leadership Council. " brings a huge amount of optimism to ticket and has a track record of reach out to swing voters."

The Kerry-Edwards team is hoping showcase that op mism at the upco ing convention. cause Kerry is s unfamiliar to m Americans—29% they have not formed an opinion him, according to July 6 CBS Ne poll—his star turn the party's Bost conclave is vital to campaign. Wh watched by a dw dling share of viewers, conventi are still launch p for White Ho challengers. That w certainly the case 1992, when an e battled Arkansas g ernor named Clinton rocke ahead of the fi President Bush a H. Ross Perot af a glitzy New Yo confab that showcased him as a workin class hero from "a place called Hope."

Yet for all this, Kerry has nagging pro lems. Although he's spent $60 million advertising over the past four months, $80 million-plus barrage of GOP atta ads that played up real and imagined K ry flip-flops has done an effective job ra ing questions about his record. Now, 5. of voters think t 20-year Senate vet an says what peo want to hear, acco ing to a June 23 CBS News/*New Y Times* poll.

Even among f low Democrats, K

Kerry's Mixed Bag

VOTERS ARE READY TO OUST BUSH...		...BUT THEY'RE NOT SOLD ON KERRY		
53% of voters say it's time for somebody new	41% approve of the way President Bush is handling the economy	37% have a favorable opinion of Kerry	55% think Kerry says what people want to hear	29% say they don't really know Kerry

Data: ABC News/Washington Post poll (May 20-23), American Research Group Inc. poll (July 1-3), CBS News/New York Times poll (June 23-27), CBS News poll (July 6)

as a ways to go to convince voters he has the right stuff. According to ne 3-13 survey by the Pew Research ter for the People & the Press, 42% emocrats give Kerry a grade of "C" orse for making a compelling case is candidacy. "His strength is that h is weak," says Pew Research Cen- Director Andrew Kohut. "He has to make the case for himself. He's associated with any big themes or ideas."

ADER NEUTRALIZER?

VARDS, TOO, HAS to brace himself nst attacks that he is nothing more a callow lawmaker with scant cre- ials for wartime duty. Indeed, 55% mericans told Gallup that Edwards' ted political experience was a weak- . To counter that perception, the y campaign will emphasize the linian's service on the Senate Intel- nce Committee and his work on the sing issues of homeland security bioterrorism.

more complicated problem for y and Edwards is Nader. Polls show if Nader wins a place on the ballot, ormer Green Party standard-bearer ld siphon away enough votes from y to erase Democratic leads in t-win states such as Pennsylvania, higan, Wisconsin, Washington, and ida. To attract Nader fans, Kerry al- ly has enlisted former foe Howard n to debate the consumer advocate. polls show that Edwards, with his cks on corporate greed, appeals to y of the angry left-wingers who like Nader.

f course, Republicans are pointing dwards' populism as further evi- e that the Democratic team is out- the mainstream. Working with Hill ublicans, the White House is hoping ighlight the social liberalism of the y-Edwards team on issues such as rights and late-term abortion. nwhile, Bush backers will portray pair as anticorporate extremists t on protectionism, re-regulation, higher taxes.

he coming GOP attacks are sure to nk Kerry's newfound lead. But just hanging in the game, uniting the y's traditional warring factions, ing himself a demon fund-raiser, making a popular vice-presidential ce, Kerry is something Democrats ed in 2000: a smart campaigner a hunger to win. ■

–By Richard S. Dunham, with Lee Walczak, in Washington,

PHOENIX There's no bubble here because building has kept pace with demand

REAL ESTATE

IS A HOUSING BUBBLE ABOUT TO BURST?

As rising rates send mortgage payments higher, demand may cool

HOW CRAZY IS REAL ESTATE getting in parts of the country? Ask Sierra and Corbin Stewart, who just bought a modest, 2,000-square-foot house in Pleasanton, Calif., for $730,000. Mortgage and tax payments will consume 55% of their income, forcing them to do without extras such as cable TV. Says Sierra, a 29-year-old marketer: "The other night we were doing our budget, and we almost called the real estate agent and said we want to get out."

It may not be long before the Stewarts—and other recent home buyers paying exorbitant sums around the country—wish they had paid attention to their cold feet. After an amazing four-year boom in residential real estate, the housing market could finally be topping

out and heading for a downturn. The culprit: rising interest rates. House prices could flatten on a national level in the next year or so while taking a spill in overheated coastal markets. A downturn in housing would squeeze recent buyers who overleveraged themselves to pay top prices—and risk slowing the entire economy by cooling consumer spending as well as housing construction, lending, and the real estate business.

It's always tricky to call the top of an overheated market, and the pessimists have been wrong before. Optimists argue that even if there is a correction, most homes will remain far more valuable than they were a few years ago. And they say immigration, second-home purchases, and boomers' inheritances will support housing. Says Angelo R. Mozilo, chairman and CEO of mortgage lender Countrywide Financial Corp.: "I think [the market] will continue to rise."

MONTHLY PAYMENT JUMP

BUT THIS TIME something important is different: Interest rates are inching up. It was the Federal Reserve-engineered decline in rates that inflated the housing bubble. But starting with a quarter-point increase in the funds rate on June 30, the Fed has begun what promises to be a prolonged tightening cycle. Even if the Fed's hikes are measured, higher mortgage rates will inevitably make houses less affordable. If 30-year fixed-rate mortgages rise just one percentage point, to 7.2% from their current 6.2%—well within the range of forecasts—house prices would have to fall 11% to keep new buyers' monthly mortgage payments from rising. If fixed rates went to 8%, prices would need to fall 20% to keep payments level.

Rising rates will hurt more than in the past because the market is more dependent on heavily leveraged buyers. Mortgage debt has shot up even faster than home values since 2000, leaving homeowners' equity at just 55% of housing value, down from 72% in 1986, according to Federal Reserve data. Leverage intensifies the pain of falling prices. If, say, a buyer owes $450,000 on a house that's valued at $500,000 and the house's price falls 10%, the equity shrinks to zero.

Heavy mortgage borrowing since 2000 has enabled the housing market to dodge an iron law: House prices can't perpetually rise faster than incomes. For the past four years, they have. The ratio of house prices to median family income is a record 3.4, a figure that's 19% above the 1975-2000 average, according to data from the Office of Federal Housing Enterprise Oversight and the Census Bureau. As rates rise, a return to the long-term-average ratio would require housing prices to fall 19%—or incomes to shoot up an implausible 24%.

A downturn in housing, if it comes, is likely to chill the economy. People will feel less wealthy, hence more reluctant to spend. Goldman, Sachs & Co. economist Jan Hatzius, among others, argues that a decline in housing wealth dampens consumer spending at least twice as much as a same-sized loss in the stock market. Even homeowners who still feel like spending would have a harder time qualifying for home-equity loans or cash-out refinancings—a major source of consumer liquidity for the past few ye

Rather than a sudden wallop, the e nomic impact would be gradual a grinding. Ian Morris, U.S. economist HSBC Securities Inc., estimates t housing prices nationally will slide 5% 10% over the next five years. That co cause economic growth to slow to 2% the second half of 2005 from 4% now predicts in a report called *The U.S. Ho ing Bubble.*

Optimists on housing point to the tional Association of Realtors' Hous Affordability Index, which shows th median-priced existing house $184,000 is easily affordable by a fan with the median income of $55,000. that's only because interest rates are low, holding down monthly paymen The juice of cheap mortgages has m housing pricey by every other meas They're high not only in comparison w family incomes but in relation to ren rates for similar properties and relativ the cost of new construction.

Federal Reserve Chairman A Greenspan has downplayed the dange a national housing bubble, arguing part that housing is a local market. S enough, prices are still reasonable in m of the Heartland, from Ohio to Texas Arizona, because construction has k pace with demand. But bubbles are pearing in enough markets that their pact, if they were to pop, would be felt tionally. Greenspan also asserts that high cost of buying and selling hou dampens speculation. Neverthel some markets are seeing speculative havior such as "flipping," in which peo buy houses or condos before they're e built and then sell them for a profit a f months later.

The overheating is greatest in mark such as Los Angeles, San Francisco, S Diego, Washington, New York, a Boston. The takeoff in coastal real est started around 2000—suggesting t the speculative fever of the late 1990s not die but instead jumped from stock real estate. From 2000 through the f quarter of 2004, single-family ho prices are up at an annual rate of 8.2% the Pacific region, 8% in New Engla and 7% in the Middle Atlantic region, cording to the Office of Federal Hous Enterprise Oversight. Prices rose 18% Los Angeles, 14% in Miami, and 13% Washington in the year through the f quarter, says the agency.

The most troublesome aspect of price runup is that many recent buy are squeezing into houses that they barely afford by taking advantage of

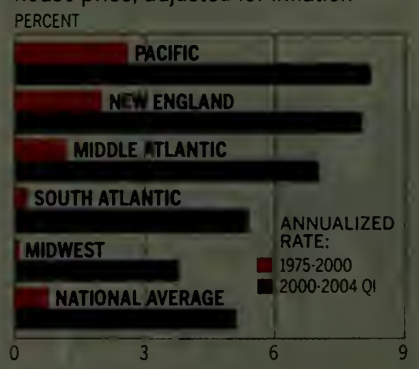
Why Home Owners Could Get Pinched

- House prices have risen far faster than incomes since 2000. The ratio of house prices to median family income is a record—and 19% above the 1975-2000 average.
- Massive borrowing has been a major driver of the housing boom. Mortgage debt has nearly doubled since 1995, leaving home equity at a record low 55% of home values.
- If 30-year fixed-rate mortgage rates rise from today's 6.2% to 7.2%, house prices would have to fall 11% to keep new buyers' mortgage payments from going up.

Data: Office of Federal Housing Enterprise Oversight, Federal Reserve, Bureau of Labor Statistics, HSBC

HOUSING HOT SPOTS

Annual increase in single-family house price, adjusted for inflation



Data: Office of Federal Housing Enterprise Oversight, Bureau of Labor Statistics

er rates available from adjustable-rate tgages. That leaves them fully ex-ed to rising rates. In fact, the rise in -year adjustable rates since late ch has already raised annual borrow-costs for new buyers by 25%. And from the Federal Housing Finance rd show that the most expensive mar-tend to have the highest share of buyers with adjustable-rate mortgages.

Today's housing prices are predicated on an impossible combination: the strong growth in income and asset values of a strong economy, plus the ultra-low rates of a weak economy. Either the economy's long-term prospects will get worse or rates will rise. In either scenario, housing will weaken. Caveat emptor. ■

–By Peter Coy in New York and Rich Miller in Washington, with Lauren Young in New York and Christopher Palmeri in Los Angeles

BusinessWeek online For more on the hot real estate market, see www.businessweek.com/magazine/extra.htm

MIDTOWN MANHATTAN BRANCH WaMu is hurt by slower business and higher costs

MORTGAGES

Lenders Switch On Their Back-Up Systems

It was a bad week in mortgage land. On June 28, two days before the Federal Reserve raised interest rates, Washington Mutual Inc., one of the nation's largest mortgage lenders, announced that its earnings for the year will be at least 17% below analysts' expectations because of lower loan volumes and higher costs. The news knocked down the shares of WaMu and other lenders as investors wondered if the nation's three-year-long mortgage bonanza might end not with a soft landing but with an earnings-plummeling thud.

Bad as the news was for WaMu investors, however, many mortgage companies that have been anticipating a downturn should hold up as the market cools. More diversified banks should see a rise in business loans if the economy continues its recovery. And mortgage lenders are emphasizing adjustable-rate loans, home-equity loans, and loan-servicing businesses that should benefit from increases in interest rates. At the same time, mergers among companies and employee layoffs are expected to lower costs. "Is the rest of the industry going to have trouble on par with WaMu? No," says Sandler O'Neill & Partners banking analyst John Kline. "But it's going to be a very soft market going forward, and it will be proven players that weather the storm best."

There's little doubt that the mortgage industry is in the last innings of a long game. Despite the many Americans who rushed out to buy homes before the hike in interest rates, new applications for mortgages for the last week of June were running at only one-third the level as the same week in 2003. For the full year, the Mortgage Bankers Assn. expects that the total volume of mortgages originated will fall 36% from last year's record $3.8 trillion. Home purchases overall are expected to be flat in dollar terms, while total refinancings could fall by more than half.

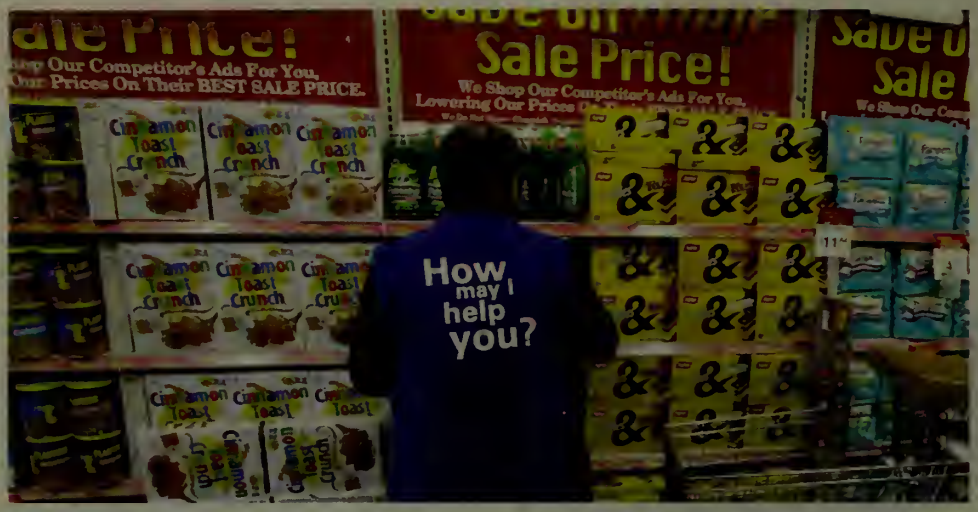
Large mortgage lenders are bracing for leaner days ahead. Countrywide Financial Corp., based in Calabasas, Calif., has shifted some of its marketing efforts from refinancings to home-equity loans and loans to customers with less-than-stellar credit histories. Those businesses are less dependent on low interest rates and considered a fairly safe bet because the company packages most of its loans and sells them to outside investors. Countrywide also retains the right to collect mortgage payments, which generates income from fees. Still, the lender expects that its earnings this year will be flat or lower than last year's. "The last three years were extraordinary," says Countrywide Chairman and Chief Executive Angelo R. Mozilo. "We're telling investors to expect more normal conditions."

Rival Golden West Financial Corp.'s strategy is to focus entirely on adjustable-rate mortgages (ARMs), a type of loan that has been gaining popularity as borrowers stretch to buy ever more expensive homes. It may be a riskier strategy, but adjustable lenders like Golden West are hoping that rising loan payments will offset defaults by buyers who bought a larger house than they ultimately could afford.

Meanwhile, consolidation of the industry and downsizing are becoming more common. On July 2, Citigroup announced that it is laying off nearly half of the 800 employees at the headquarters of its recently acquired Principal Financial Group mortgage business. Even WaMu may be a takeover target: The company, which has grown rapidly through a series of acquisitions, has seen its own stock bounce around on merger rumors.

For the past three years, mortgage lenders have been on Easy Street. Over the next three, only the savviest will thrive.

–By Christopher Palmeri in Los Angeles



RETAILING

THERE GOES THE RAINBOW NUT CRUNCH

To stay competitive, food companies are weeding out their slow-selling products

GO INTO ANY SUPERMARket, and it's hard to miss General Mills Inc.'s storied brands. The packaged-food giant makes everything from Cheerios cereal and Progresso soups to Green Giant frozen vegetables. But in the coming year, shoppers may find it harder to find their favorite size or flavor. On June 30, General Mills announced it would trim by 20% this year the number of products it sells.

General Mills is not alone. From H.J. Heinz Co. to Hershey Foods Corp., most big packaged-food companies are weeding out their slow-sellers. In part, they are doing so to cut costs in the face of rising commodity costs. But there's more to it. Increasingly, the food companies are taking their orders from Wal-Mart Stores Inc., which wants only products that fly off its shelves. At the same time, the food brands are being crowded out by grocers' own labels. "It's getting a lot harder to survive on the store shelf," says Gary Chartrand, chief executive of Acosta Sales & Marketing Co., the nation's largest broker for food and consumer products.

Higher commodity prices, insists Minneapolis-based General Mills, are a key reason it is winnowing its product lines. Prices of soybean oil and cheese have risen by 70% and 80%, respectively, in the past year. At General Mills, that translates into a 10% boost in commodity costs, or $165 million, estimates Deutsche Bank Securities. Killing off one-fifth of its products will help cut costs because the company will be able to focus on better-selling items.

Scaling back on products could boost profits. But it hardly assures sales growth. Consider Heinz, which in the past two years has shed 40% of its items to concentrate on movers such ketchup in an e to-pour ups down bottle. want to focus on products that are or No. 2 in their categories," says Smyth, a Heinz senior vice-president. move seems to have paid off. In f 2003, operating income rose 17.5% $1.38 billion. But unit volume growt mained virtually flat at 0.4% last yea remains to be seen whether putting sources behind fewer brands ultima leads to better growth," says Deut Bank analyst Eric Katzman.

Not Welcome on the Shelf

Why packaged-food companies are offering fewer sizes and flavors:

BIG KAHUNA Wal-Mart, the nation's biggest grocer, wants to give the most space to the hottest sellers, so it's forcing wholesalers to narrow their offerings

PRIVATE LABEL The rising popularity of private-label products means food companies must put only their best-sellers on the shelves or risk being elbowed aside

RISING COSTS With raw-material prices soaring, foodmakers hope to boost efficiency by making bigger batches of fewer products

ONLY THE FITTEST Wal-Mart won't stock an item if demand is tepid

RUTHLESS CUTS

BUT FOODMAKERS have little choi thanks to Wal-Mart's growing clout. like other grocers, it doesn't charge pliers "slotting fees" to put goods o shelves. It goes with what sells, bump up to 20% of its products each year analysts. What's more, the nati biggest grocer carries 20,000 fewer it than most supermarkets, says consul firm Retail Forward Inc., meaning competition for shelf space.

Big supermarkets such as Kro Safeway, and Albertson's are making harder for foodmakers, too. To differ ate themselves from Wal-Mart, they expanding their produce, deli, and departments. But those products typ ly are sold around a store's peripl shrinking space in the center aisles w packaged foods are sold. Grocers are moving faster to introduce their brands. During the past decade, stor bel products have risen from 15% of grocery sales to 20%, according Midwest Research. These are not the generic products that your mo bought but range from premium cream to microwavable meals of com rable quality to the national brands.

Pressure on packa food companies will worsen. That's bec Wal-Mart, too, is contin to expand its private la In five years, says R Forward, the giant's brands will account for of its grocery sales, up f 20% today. Just one r reason why the battle shelf space is going to tougher and tougher. ■

–By Robert Bern Chicago, with Diane B in New York and W Zellner in D

"Deploying our ERP application on our tight deadline would have been impossible. With Citrix, we not only made our deadline, we also drastically reduced our deployment costs."

Curtis Robb, CIO
Delta Air Lines, Inc.

access

INFRASTRUCTURE FOR THE ON-DEMAND ENTERPRISE

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COMMENTARY

BY PETER BURROWS

Why Apple Needs to Shine Up iMac

Despite iPod's success, the company gets most of its sales from computers

APPLE COMPUTER Inc. is known for its remarkable ability to wow the world with its hot new products. That's why its July 2 announcement was so disappointing. Without citing specific reasons, the company said it would not roll out a new version of its iMac home PC until September, rather than in July, as it had hoped. Since the outfit also announced that it would run out of stocks of the existing iMac in a few weeks, Apple won't have a home PC to sell for the most crucial part of the back-to-school buying season. Investors reacted quickly, pushing down the stock 3.7% that day, to $31.08.

It was a stark reminder that Apple does more than make the iPod. Given the ubiquity of the elegant little music player, it's easy to forget that Apple is still at heart a computer company. While commanding just 2.8% of the global PC market, the company's line of Macintosh PCs—including the iMac, PowerBook, and PowerMac G5—still accounts for 58% of its overall revenues. By focusing so hard on the iPod and the iTunes Music Store, has CEO Steven P. Jobs taken his eye off the Macintosh franchise?

JOBS Delaying the latest iMac hurt shares

By itself, the iMac delay doesn't prove that he has. Despite investor jitters, the postponement will have a negligible effect on Apple's already depleted market share or on earnings. In fact, analysts think Apple will actually save money by not incurring the cost of extending the life of the current, aging iMac by a few more weeks. Since Mac customers are loyal to the brand, "they're not going to miss much in terms of lost sales," says NPD Group Inc. analyst Stephen Baker. But Apple can't afford many more missteps, because it needs the Mac to pull its weight.

The company has less margin for error than meets the eye. Analysts expect Apple to rack up $235 million in net earnings this year, double last year's tally. But Apple relies more on interest from its $4.6 billion cash horde than do rivals. Backing out its expected after-tax $34 million in investment income, Apple's net would fall to $201 million on expected sales of $8 billion, says Albert Meyer, a general partner with 2nd Opinion Research. What's more, if the company were forced to expense options, as exp ed, that number would fall at least 50%, to just $100.5 milli says Meyer.

That's why reinvigorating the iMac is urgent. Apple needs i help regain share in the education market, where the comp has staged a modest comeback in recent months, grabbin 14.1% share in the past quarter, up from 12% in the fall, says I While more students are opting for laptops such as the Pow Book, Apple needs a strong iMac to prevent further share ga by now-dominant Dell Inc.

What's more, having evidently made peace with its mea market share, Apple is now clearly milking the Mac for profits. ter all, its PowerMac and PowerBook models reap fatter marg than the iPod, especially when loa with Apple's iLife suite of software. T company also is charging higher pre ums for its PCs than are rivals. T years ago, says First Albany Capital I analyst Joel Wagonfeld, the aver selling price of a Mac was $154 hig than that of a Windows PC. Now about $400 higher.

There could be good news on the M sales front, too. A revival in the adver ing industry may boost sales of the PowerMac so prized by creative ty And while only 3% of full-time coll students now own a PowerBook lapt 14% intend to buy one, says researc Student Monitor. Mac sales could another bump when Apple introduce new version of its operating syst dubbed Tiger, next year.

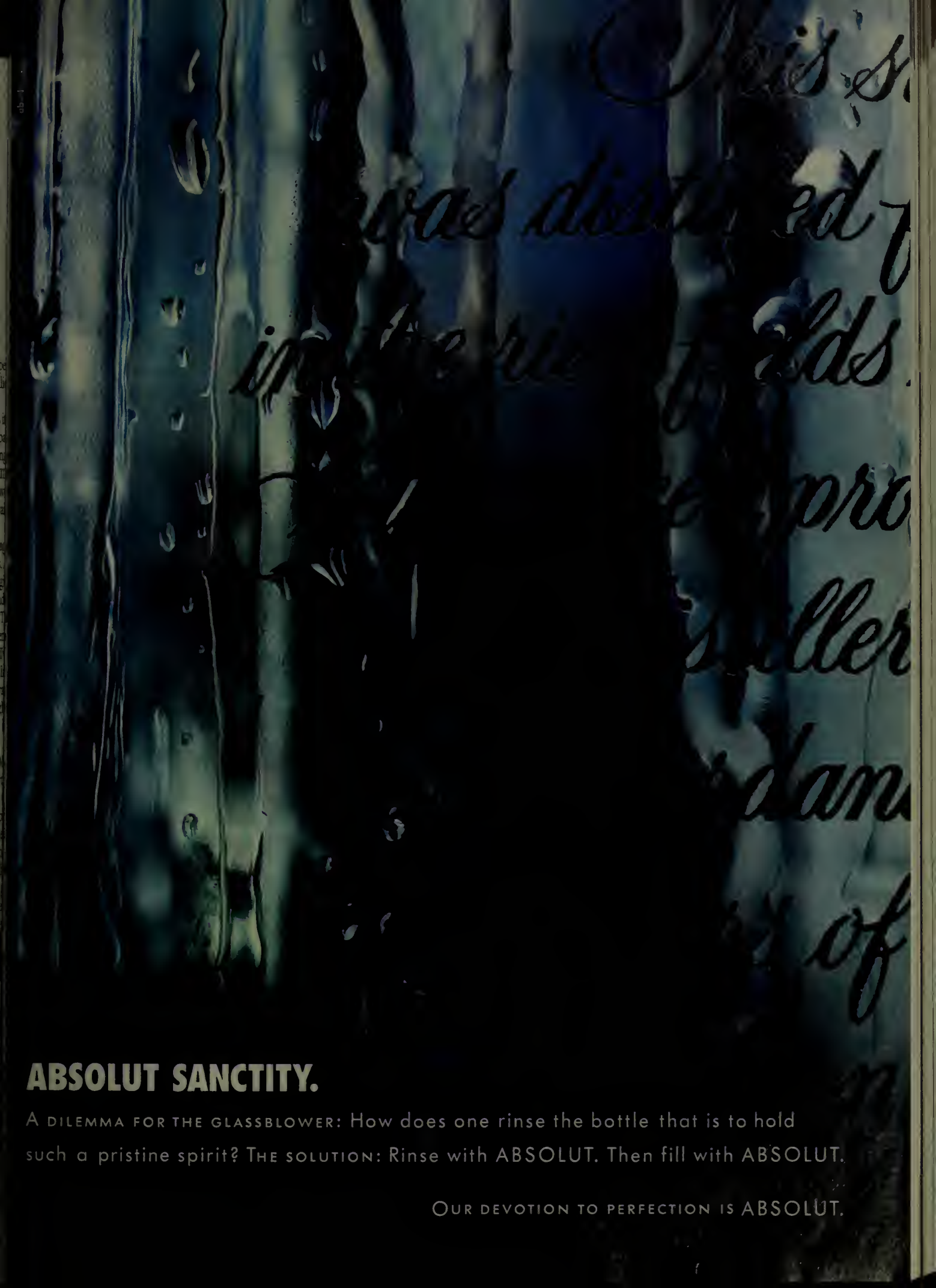
If the new iMac is a Jobs's focus on innovation again be vindicated. It's structive that investors did hammer the stock harder u learning of the iMac del Shares are still up 42% for year, compared with De 2.7% rise. Rather than dema Microsoft-style market share Dell-like operational consist cy, investors value Apple's c products. When you build c cept cars for the industry, th are bound to be some crash This one won't be fatal. ■

THE STAT

13%

iMac sales as a portion of Apple's overall revenues, down from 35% in late 1998, soon after the PC's launch

Data First Albany Capital Inc



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EDITED BY MONICA ROMAN

HEADLINER

HARRY STONECIPHER

IN YOUR FACE, AIRBUS

More good news for Boeing CEO Harry Stonecipher. A month after winning a key defense contract, Boeing got some unexpected lift from its commercial airplane unit. On July 7, it announced the first European customers for its new, fuel-sipping 7e7 jetliner. Two charter carriers—Blue Panorama of Italy and First Choice Airways of Britain—ordered a total of 10 of the 230-passenger jets, worth about $1.2 billion. That boosts the tally to 62 new 7e7 orders since Boeing launched the program in December.

Since taking the controls at Boeing in December after his predecessor resigned in the wake of an ethics scandal, Stonecipher has been working overtime. His goal: to get the nation's No. 2 defense contractor out of the penalty box. And he's getting results: The U.S. Navy in June awarded Boeing a $3.9 billion development contract to build a submarine-hunting airplane. If the Navy takes all 109 modified 737s as planned, it will mean $15 billion in sales. Stonecipher's turnaround of Boeing is clearly gaining altitude. *–Stanley Holmes*

REVVING UP REBATES

After a month of stalled car sales, **General Motors** and **Ford Motor** are hoping that new incentives will lure buyers back. GM, whose sales fell 15.5% in June, is offering a $5,000 rebate on most trucks and $4,000 on cars. Ford is playing a similar card, hoping to reverse its 8% June sales slide with 0% financing deals on many models. This is sure to keep margins thin. In June, auto makers were already offering big deals to car buyers. GM led the industry with an average incentive of $4,091 per vehicle, says Merrill Lynch. Ford was second, with incentives averaging $3,679. Those are sweet deals, considering that the average incentive in June for all carmakers was just under $3,000 a vehicle.

BURGER KING'S CROWN PASSES

Bradley Blum won't be having it his way at **Burger King** anymore. The former **Olive Garden** executive handed in his resignation as CEO on July 2, citing "strategic differences" with the company's board. His departure—the ninth Burger King chief to exit in the last 15 years—complicates efforts of the ailing burger chain's new owners, led by buyout firm **Texas Pacific Group**, to fix its Whopper-sized problems. While same-store sales ticked up 7.2% in May, total U.S. sales have declined for five years in a row, and seven Burger King franchisees controlling more than 600 restaurants have filed for bankruptcy in the last two years. Soggy sales and shrinking franchises mean Wendy's International could soon supplant Burger King as the nation's second-largest hamburger chain, behind **McDonald's**.

PEOPLESOFT: SOFTER SALES

The stress of fending off a hostile takeover by rival **Oracle** may finally be taking a toll on **PeopleSoft**. The Pleasanton (Calif.) maker of business software on July 7 said second-quarter sales were between $655 million and $665 million, with a net profit in the range of $10 million to $18 million. Both fell short of Wall Street's expectations. PeopleSoft blamed customer hesitance in the face of Oracle's takeover bid. The fight moved into high gear in June when the **Justice Dept.** argued in federal court that Oracle's bid should be blocked on antitrust grounds. A decision is expected in a month.

A SUBSCRIBER ROLL CALL

It's not quite Subscribergate, but the **Securities & Exchange Commission** has sent letters to the nation's cable, telephone, and now satellite companies. The SEC wants to determine if the companies are accurately reporting numbers of subscribers, a key measure of performance. Satellite operators **DirecTV** and **EchoStar Communications** have received letters, joining mo than 20 companies, includ cable giant **Charter Communications** and phone companies **AT&T**, **BellSouth**, and **Cingular Wireless**. All sa they would cooperate with inquiry. The letters come a **Verizon Communications** acknowledged that it overstated the number of it long-distance customers.

ET CETERA...

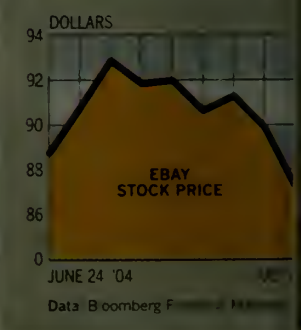
» The government did no renew a contract with defense contractor **Titan.**

» The **FTC** began a formal probe of a **Shell** refinery closing in California.

» The **SEC** began probing mutual-fund payments to retirement plans.

CLOSING BELL

Is eBay nodding off After rising 48% th year, its shares fell 6% from a June 28 high to $86.87 on July 7. Some of the decline came after Prudential Equity Group cut its rating to "neutral." The Web marketplace's typically slow summer is unlikely to ignite the stock, Pru says.



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ITED BY RICHARD S. DUNHAM

'iracy Wars: Hollywood 'urns Its Guns on Tech

R THREE YEARS, Hollywood and Silicon Valley have maintained uneasy truce. Beset by illegal copying, makers of movies, mu-, and software focused on file-swappers—not companies that ıde the technology pirates use. But all that changed in April, er a U.S. District Court in California threw out the studios' against Grokster Ltd., saying the com-y could not be blamed if its software used to make illegal copies. West In--based Grokster and other file-swap- networks thumbed their noses at ieland, trumpeting on their Web sites a U.S. court had deemed them legit. 'hose boasts broke the détente—and Hollywood & Co. want revenge. On e 22, top Senate Judiciary Committee nbers Orrin Hatch (R-Utah) and rick Leahy (D-Vt.), took aim at Grokster its ilk with legislation that would make crime to "induce" people to violate yright—by implying, for example, that vnloading pirated music is legal. Hatch Leahy have the back- of Senate Majority der Bill Frist (R-Tenn.), ıority Leader Tom chle (D-S.D.), record- and movie industry vies, and even Micro- Corp.

'hat might be enough quash the Groksters of world, but the Inducing ingement of Copy- ıts Act of 2004 is stir- up formidable opposi- ı. In a July 6 letter to ch, 43 tech companies l trade groups, includ- Intel, eBay, Google, I, Sun Microsystems, and Verizon Com- nications said the bill could let content ners use lawsuits to kill off nascent tech- ogies they find threatening. It might n undo the Supreme Court's 1984 Beta- decision, which declared that makers VCRs couldn't be held liable if people d the machines to tape TV programs. ıis gives Hollywood an extremely pow- l litigation tool that will freeze invest- nt in technology," says Philip S. Corwin, a lobbyist for Sharman Networks, distributor of KaZaA file-sharing software.

COPYRIGHT COPS Leahy and Hatch are after those who "induce" piracy

File-Swapping Marches On

CONTENT OWNERS SAY they have no beef with gadgets such as DVD burners or Apple Computer Inc.'s iPod. Sure, Hollywood has sparred over such devices before—witness the heat Apple took for its edgy "Rip. Mix. Burn." ad campaign a few years back. But this time, "the target is the bad actors that have hijacked technology," says Mitch Bainwol, a former Frist aide who now runs the Recording Industry Association of America, which helped draft the bill.

Hollywood wouldn't be calling in its chits if it weren't suffering setbacks. The RIAA has spent millions of dollars suing thousands of individuals over illegal file-swapping, but peer-to-peer downloads still measure in the millions. And political pushback is building. In the House, Representative Joe Barton (R-Tex.)—who is sympathetic to consumer complaints that content owners are overreaching—has replaced a starstruck Billy Tauzin (R-La.) as chairman of the Energy & Commerce Committee. And electronics makers are joining forces with P2P companies and consumer groups to try to turn back limits on copying. "The whole fight is escalating," says Gary Shapiro, CEO of the Consumer Electronics Assn. "This is a battle royal."

Hollywood vs. the Valley—a clash of titans indeed. But for the movie, music, and software industries, the real foe is technology—and all the campaign contributions in the world can't hold back that tide. ■

–By Lorraine Woellert

CAPITAL WRAPUP

THE LAW OF THE SEA FACES CHOPPY WATERS

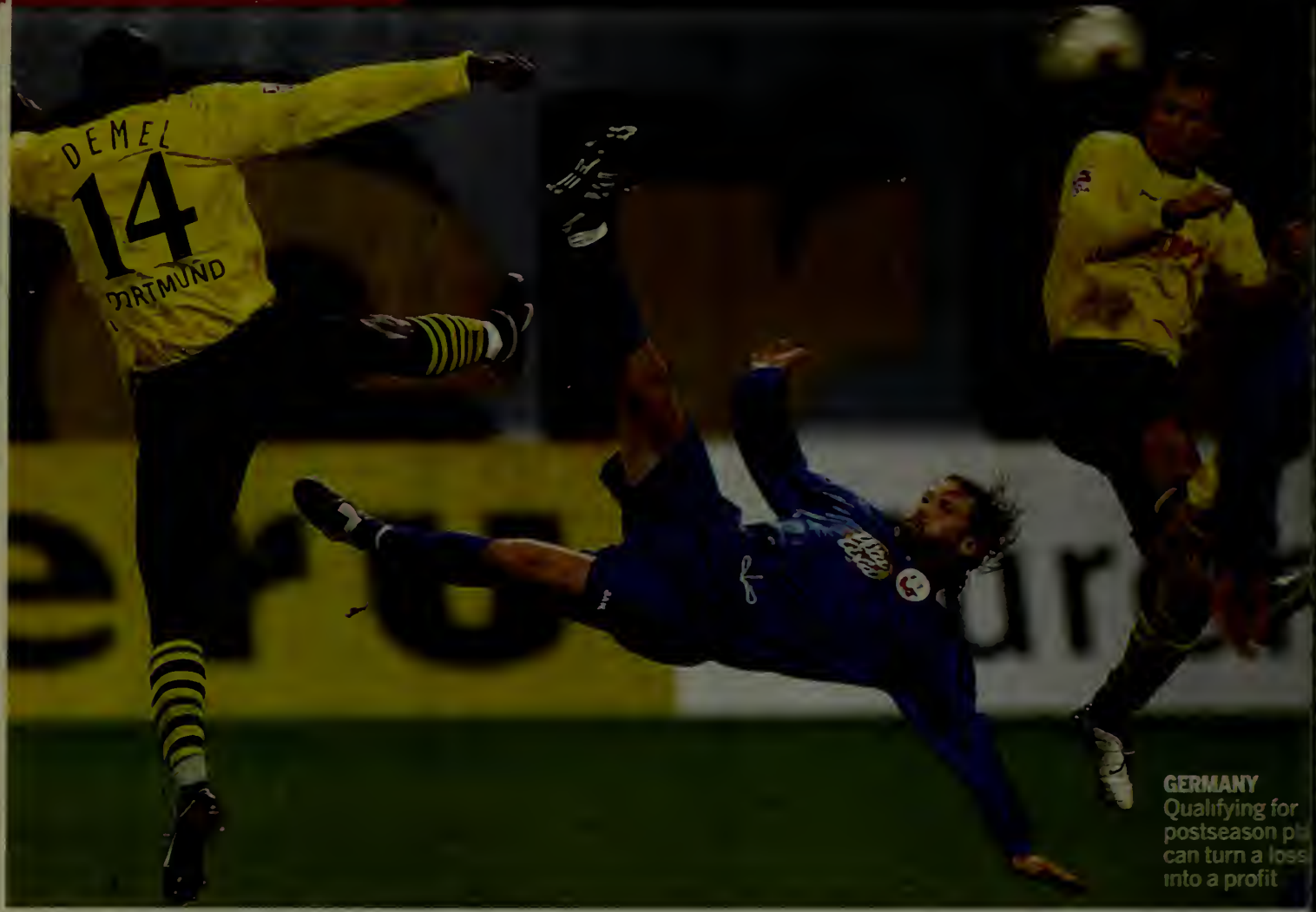
WHEN THE SENATE Foreign Relations Committee approved the 1982 U.N. Law of the Sea Convention in February, it looked like clear sailing for the pact. The accord, whose rules for navigation rights, commerce, and environmental protection of the seas took effect a decade ago, was a top Bush treaty priority. The Navy, industry, and environmentalists were on board. And the pact had been fixed in 1994 to meet U.S. objections to seabed mining rules.

But the GOP's right wing could doom passage, according to congressional sources, because White House political guru **Karl Rove** wants to placate Bush's political base. The deal: Conservatives won't blast Bush for nation-building in Iraq if he doesn't push the treaty.

The Republican right fears the accord would reduce U.S. sovereignty and hobble the Navy—though the Pentagon disagrees. A top Administration official says the Senate leadership controls the voting schedule but doesn't deny Rove's role. GOP treaty backers fret the U.S. won't be at the table with the 145 signatories to protect its interests when the pact is open to amendment in November.

WHAT'S IN A NAME? UTAH DEMS SEE HOPE

UTAH IS ONE of the most Republican states, but there is one magic name for Democrats: **Matheson.** The late Scott Matheson was a revered governor from 1977 to 1985. His son Jim is the state's only Democratic congressman. This year, another son, **Scott Jr.,** is running for governor. But times may be changing: He's trailing Republican **Jon Huntsman Jr.,** son of a billionaire industrialist.



GERMANY Qualifying for postseason p can turn a loss into a profit

EUROPE

CAN SOCCER BE SAVED?

As its popularity soars, the gap widens between have and have-not teams

THERE WAS NO WAY European soccer fans could miss Adidas' new Roteiro ball last month. Thanks to a deal between Adidas-Salomon and the Union of European Football Assns., the silver and black Roteiro was the only ball to appear on the pitch during the European soccer championship in Portugal from June 12 to July 4.

Beckham bent it, Zidane juggled it, and even the animated logo that appeared during programming transitions often displayed the Roteiro. Inside of a few weeks the Herzogenaurach (Germany)-based Adidas sold 6 million Roteiros, top models of which retail for over $120 each. "You get exposure you simply couldn't achieve without an event like this," says Adidas CEO Herbert Hai

Adidas' success was testament to awesome commercial power of soc European clubs probably topped $12 lion in revenue in the most recent seas while soccer teams in Britain, Germ France, and Italy have tripled sales si the mid-1990s. The game generates s $3.1 billion annually just in sales brand-name, soccer-related produ such as jerseys. The British soccer c Manchester United has annual sale $317 million, handily topping the $ million earned by the New York Yank according to Deloitte Touche Tohma Players such as midfielders David B ham and Zinédine Zidane, both with R Madrid, are household names in Ch and India as well as Europe.

Great business, right? For top playe handful of teams, and a few sponsors s as Adidas, Nike Inc., and Vodafone Gr PLC, it sure is. Yet many of the organ tions at the core of the sport—the rou 400 first-division teams from Irelan Ukraine—are in dismal financial sh Clubs typically have a shot at turnir profit only if they qualify for the elite U Champions League or the UEFA Cup two main postseason tournaments.

ven top teams in soccer-crazy coun- lose money. Deloitte estimates that 's first-league clubs collectively lost ut $360 million last year. It all adds to a crisis which, if left unchecked, d leave the whole game permanently kened. Even in the much-admired ish Premiere League, probably only teams out of 20 made a pretax profit e season just ended, according to De- e. "[Soccer] is not just a game, it's a h business," says Erwin Staudt, for- chief executive of IBM Germany and boss of VfB Stuttgart, which plays in top-tier Bundesliga.

ISKY BUSINESS

AT'S WRONG WITH the way the e is played? "The problem is runaway ries," says Stephen Schechter, owner chechter & Co., a London firm that s soccer clubs issue bonds. Power- se Real Madrid paid $42 million for id Beckham last year, after paying ut double that for Zidane in 2001. And teams far down the league tables d huge sums on players in an often- le bid for elite status. VfL Wolfsburg $11.4 million for midfielder Andres lessandro in 2003, but still finished last season. Real Madrid's massive stment in Beckham and Zidane was good for a fourth-place finish in in's first division.

Germany's Borussia Dortmund shows teams get in trouble when they over- tch. The club paid $31 million in 2001 forward Marcio Amoroso. But he was lined with a knee injury and released the team in April. Then Dortmund ed to qualify for the UEFA Champions gue last season and lost early in the FA Cup. Without the extra revenue n television rights that those pan-Eu- ean tournaments bring, sales fell 38%, $62 million, in the six months to De- ber. The team reported a loss of $35 lion, compared with a profit of $8.7 lion a year earlier. The full depth of the rt's financial problems isn't known; st teams are privately held. But one m executive says that few German ks will lend to pro teams because of risk. Teams in Italy, Spain, and France believed to be in even worse shape.

The very organization of the system sts the risks. Membership in every ntry's first league is fluid. In Germany, bottom three teams out of 18 drop n to the second league at the end of season and the top three second-league ms move up to the first league. That ls to the drama. But it's hell from a busi- s point of view: Revenue can drop by half if a team slides to the second league. "The parameters are totally different than any other business," says Robert Müller von Vultejus, managing director of Hamburg-based sports marketers Sportfive.

The rewards get richer, and the winners fewer, when the game is played at a European level. A few superteams almost always qualify for pan-European play, such as Italy's Juventus, AC Milan, Real Madrid, Bayern Munich, and Manchester United. A berth in the UEFA Champions League final can add more than $50 million in revenue, Deloitte estimates. In fact, some in the industry predict that soccer is moving toward a pan-European league that will hog the big sponsorship and TV money. "Club owners that can support the costs will keep moving ahead. Others won't be able to and will have to give up," says Paolo Taveggia, a former manager of Milan Associazione Calcio, better known as AC Milan.

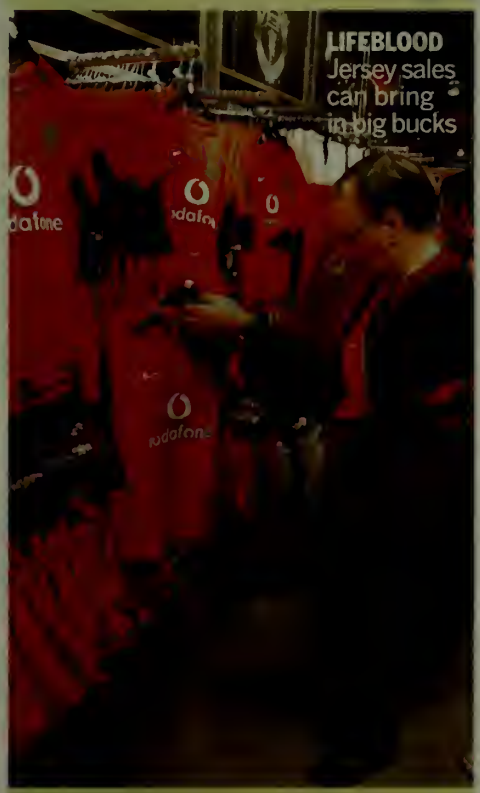
Soccer's problems have nothing to do with its popularity, which is on the rise. TV viewership for the European championship in Portugal, known as Euro 2004, was up 26% over the last tournament in 2000, according to UEFA. What hobbles many teams is the lack of professional management. Managers, often ex-players, lack basic business expertise. Teams fail to fully exploit merchandising or sponsorship opportunities. "There are ways to make money in pro soccer, but not many clubs are using them," says Björn Bloching, a Hamburg-based partner at Roland Berger Strategy Consultants.

Manchester United is the industry standard. The team builds a global fan base by playing exhibition games abroad. International markets account for 40% of sales of Man U jerseys, largely because of a $520 million deal with Nike under which the sports-apparel maker handles all of the team's merchandising. Man U also limits player salaries to 50% of revenue. And Manchester survived the departure of international star/sex symbol Beckham to Real Madrid. "The Manchester United brand is more powerful than the Beckham brand," says Marco Forato, a director of consultancy FutureBrand.

Now other teams are copying the Man U playbook. Marseille is scouting for players in China to attract fans there. Turin-based Juventus Football Club will open a shopping center inside its new stadium, including a Nike store. Thanks to such measures, there are signs of a financial recovery in some areas of the sport. Sales in England's Premiere League rose 7% last season, to $2.4 billion, according to Deloitte. Player salaries could begin to

How Europe's **soccer** teams get into trouble...

- Frittering away IPO proceeds on inflated player salaries rather than investing in stadiums
- Getting caught off guard by collapse in revenue from TV
- Expanding into businesses they can't manage, such as retailing
- Failing to implement basic cost controls
- Letting ego trump business logic



LIFEBLOOD Jersey sales can bring in big bucks

... And how the **best teams** are getting back into the game

- Linking player salaries to performance
- Increasing stadium capacity to add premium seats, "business boxes"
- Letting companies such as Nike, Adidas, and Puma operate fan shops
- Intensively recruiting young talent for in-house "football academies"
- Setting realistic goals, aligning costs accordingly
- Recruiting players from places like China to build an international following

go down as existing contracts expire.

Sponsorship revenue has also been rising. German electronics giant Siemens decided to sponsor Real Madrid, in part to reach potential customers in China. "It's a very cost-efficient way to advertise," says Rolf Beisswanger, chief of global sponsoring for Siemens' mobile telecommunications division.

Salaries for stars like Beckham are now sky-high

But teams popular only in their home regions risk slipping into a vicious circle: Declining revenue makes it difficult for them to afford stars; that hurts team results, which in turn further depresses sponsorship and ticket sales.

Starting in the coming season, UEFA will bar clubs from competition if they fail to meet basic criteria, such as paying players on time. European Union antitrust authorities are also expected to crack down on hidden subsidies such as tax breaks for teams, which are perceived to be widespread in Italy and Spain. The measures should help keep player salaries in line. Soccer associations may also do more to share TV revenue from international competition.

There is little chance, though, that European leagues will soon change their multi-tier structure and create a permanent elite league, as with major league U.S. teams. But pressure is building to create something in between, such as an elite league that would occasionally add up-and-coming teams and eject perennial cellar dwellers. Few companies can survive unscathed the huge cuts in revenue that occur when a team slips out of the elite. "The success of the company can depend on the two centimeters that determines whether the ball went over the line or not," says Bernd Schiphorst, president of Berlin's Hertha BSC team. Winner take all? That approach makes sense in a brutal, Darwinian way. But it's also a good way to trash an entire sport. ■

–By Jack Ewing in Lisbon with Laura Cohn in London, and bureau reports

COMMENTARY

BY BRIAN BREMNER

Thin Ice for Koizumi

Why Japan's Prime Minister is facing voter backlas

COULD JAPANESE Prime Minister Junichiro Koizumi be out of a job soon? That prospect is spooking Japan's markets in the runup to Upper House elections on July 11. Despite Japan's surging economy, polls show Koizumi's Liberal Democratic Party trailing the Democratic Party of Japan. Although the election won't determine who runs Japan—the government's ruling majority comes out of the Lower House—it's a crucial litmus test. And some LDP elders are saying Koizumi ought to resign if the party takes a drubbing. Given the robust economy, "Koizumi should be getting a lot more support than he is—it appears to be unfair," says Akio Mikuni, co-author of Japan's *Policy Trap*, a book on the financial challenges confronting the country.

What gives? Few fault Koizumi for his handling of the economy, but he's taking the heat for two unpopular policies: pension reform and support for the U.S. in Iraq. In an effort to shore up Japan's nearly insolvent pension system, the LDP-led coalition in June hiked p miums and cut benefits, alienating m lions of retirees. And in the sprin Koizumi dispatched 550 soldiers to Ir despite massive public opposition.

So is it time to contemplate a Jap without Koizumi? Not so fast. The LDP shooting for 51 of the 121 seats up grabs, but even if it wins only 45—wh seems doable—it will still hold an over Upper House majority. And a recent p found that voters prefer the LDP'S e nomic policies to the DPJ's.

But after a bad LDP showing, pa elders could force a Cabinet reshuff Anti-reform elements might then d mand the resignation of the man th love to hate, Economy & Financial Se vices Minister He Takenaka. Withc the forceful Takena on board—he earl crushed LDP oppo tion to bank reform Koizumi's efforts close Japan's yawni budget gap and priv tize state-owned sets might fall by t wayside. Foreign vestors could bail o of Japanese stoc and bonds. And K zumi would spend t rest of his term, whi ends in 2006, esse tially a figurehea "This could be a sli pery slope," war James Barber, an ar lyst with Barcla Capital Resear Japan. Koizumi w probably keep his jo But unless he and t LDP prove the po wrong on July 11, could be facing tough stretch. ■

Sagging Support

Despite Japan's surging economy, Koizumi's approval rating is down

January	July
53.3%	35.7%

Data: Yomiuri Shimbun

ISSIA

'UKOS: THE MOMENT OF RECKONING

uge tax and loan bills are now past due. ow will Putin choose to wield his ax?

LL YUKOS SURVIVE? By July 8, Russia's second-largest oil com- ny was supposed to pay a crippling $3.4 billion back-tax l—but it has only $1.4 billion in cash. Meanwhile, on July 2, kos was declared in default of a $1 billion loan from a con- rtium of Western banks, although the banks have so far re- ained from demanding immediate payment. These latest elopments mean that the long-run- g Yukos case is heading toward a cli- x. Investors are desperately hoping a resolution: Russia's RTS Index has t 27% of its value since April. Corre- ndent Jason Bush provides a guide to s very Russian piece of financial-polit- l theater.

at is the Kremlin trying to achieve?

itical insiders and analysts in Moscow gely agree on one thing: Vladimir V. tin's main goal is to change the owner- p of Yukos and replace the company's sent majority shareholder, Mikhail B. odorkovsky's Group Menatep, with neone the Kremlin likes. Khodor- vsky, Russia's richest tycoon, fell out th the Kremlin last year by meddling in litics and faces trial on charges of fraud d tax evasion. Dispossessing Khodor- vsky may well mean some form of re- tionalization of Yukos, although the me objective could be achieved by nsferring Menatep's shares to new pri- te owners with the Kremlin's blessing.

w could a renationalization—or change ownership—occur?

e government could seize Yukos' as- ts in lieu of taxes, then auction them f to new owners. While the total tax ims could eventually top $10 billion, kos' assets are estimated to be worth ree or four times as much. The worry that the state may deliberately under- lue them to justify grabbing a larger are of the company and thus acquire control. But in that case, minority shareholders would be outraged, and Russia's investment climate could be damaged for years to come.

UNGILDED CAGE Khodorkovsky has little leverage left

The government could decide instead to seize Yukos' 35% stake in Sibneft, another Russian oil company. That shareholding is worth $4 billion. But such a move would leave Yukos intact and—annoyingly for the Kremlin—still majority-owned by Khodorkovsky. Another way for the government to take control of Menatep's stake would be a deal under which Khodorkovsky would sell or surrender his shares.

Are there any signs of a deal?

There are growing signs that Khodorkovsky is willing to give up some or all of his shares in Yukos to the government, either in direct settlement of Yukos' tax bill or as a security for the payments, which would then be rescheduled over several years. In a July 7 statement, Khodorkovsky's lawyer said the tycoon had recommended that the Yukos board offer his shares as a way to negotiate the tax bill.

What does Khodorkovsky want?

He no doubt is angling for some compensation. If his shares are sold or pledged, they should, at fair valuations, be worth more than the government's tax demands. His stake was worth $15 billion before the tax demands drove down Yukos' stock price.

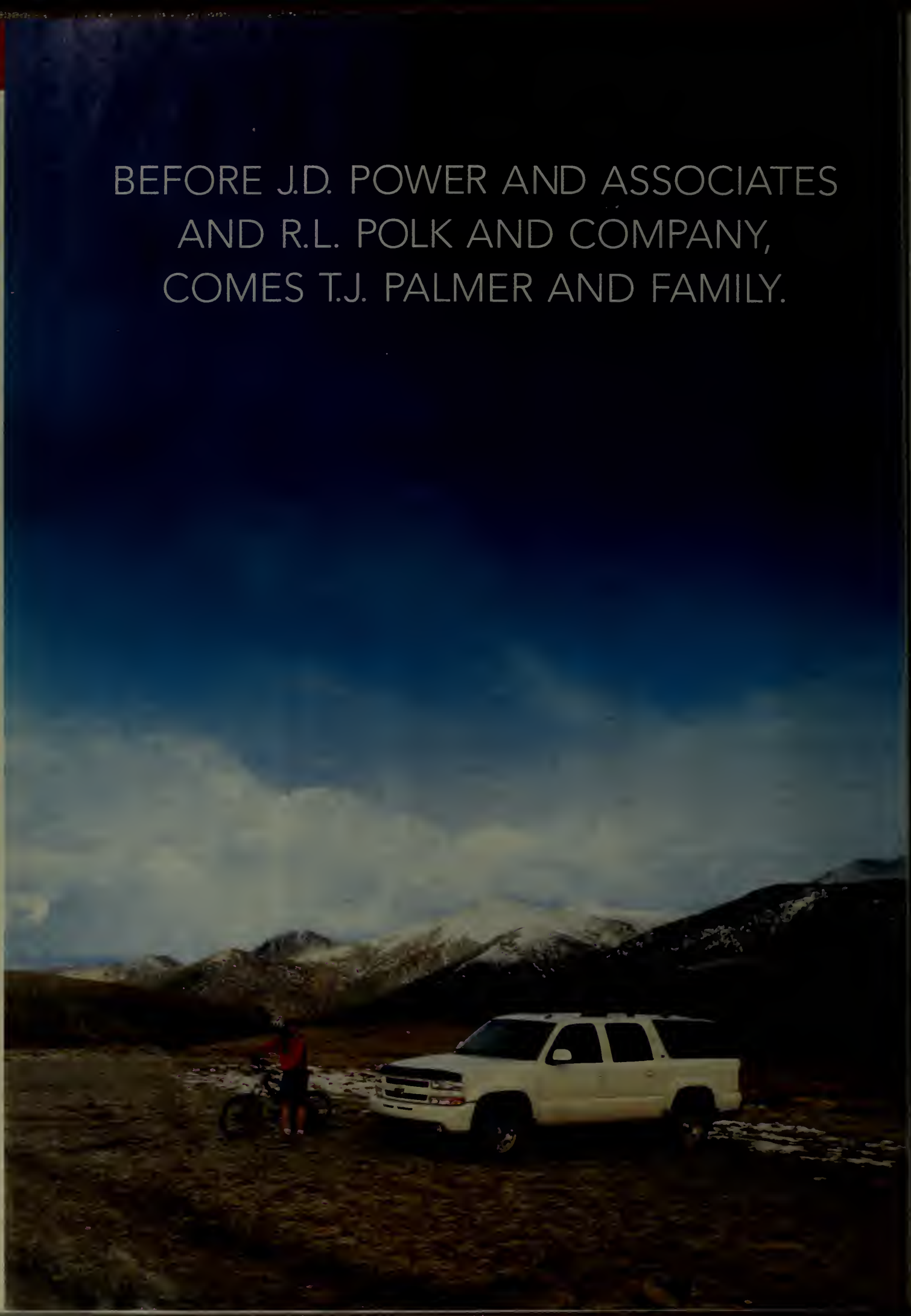
What are the other alternatives?

If there's no deal, Yukos minority investors hope that the criminal case against Khodorkovsky and a partner, Platon Lebedev, due to resume on July 12, will solve the puzzle. These accusations are legally separate from the tax claims, and relate to the allegedly fraudulent privatization of the Apatit fertilizer company as well as to tax evasion. If the tycoon is convicted, he'll have to repay $1 billion that prosecutors say he embezzled—plus any fines the court imposes.

Some analysts believe the Kremlin may also be able to get the court to find a legal pretext for full confiscation of Khodorkovsky's shares in Yukos. With Khodorkovsky thus out of the picture, the state could happily negotiate with Yukos about ways to settle its tax debts, thereby avoiding the wrath of Yukos' minority shareholders and the economic consequences of a Yukos bankruptcy, which Putin has said he wants to avoid.

The snag is that the state still has to convict Khodorkovsky, whose trial will drag on for several more weeks. In the meantime, the noises of distress from Yukos are getting louder as creditors begin to lose confidence in the outfit's solvency. If Putin does not act soon, it may become too late to save the company—whatever the Kremlin wants.

BEFORE J.D. POWER AND ASSOCIATES
AND R.L. POLK AND COMPANY,
COMES T.J. PALMER AND FAMILY.



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**General Motors Corp. – Lansing Grand River, MI (Car) plant was the highest ranked and the General Motors Corp. – Hamtramck, MI plant was the second highest ranked in North/South America among plants producing vehicles for the U.S. market. J.D. Power and Associates 2003-2004 Initial Quality Studies.℠ 2004 Study based on a total of 51,208 U.S. consumer responses including owner reported problems during the first 90 days of ownership. www.jdpower.com

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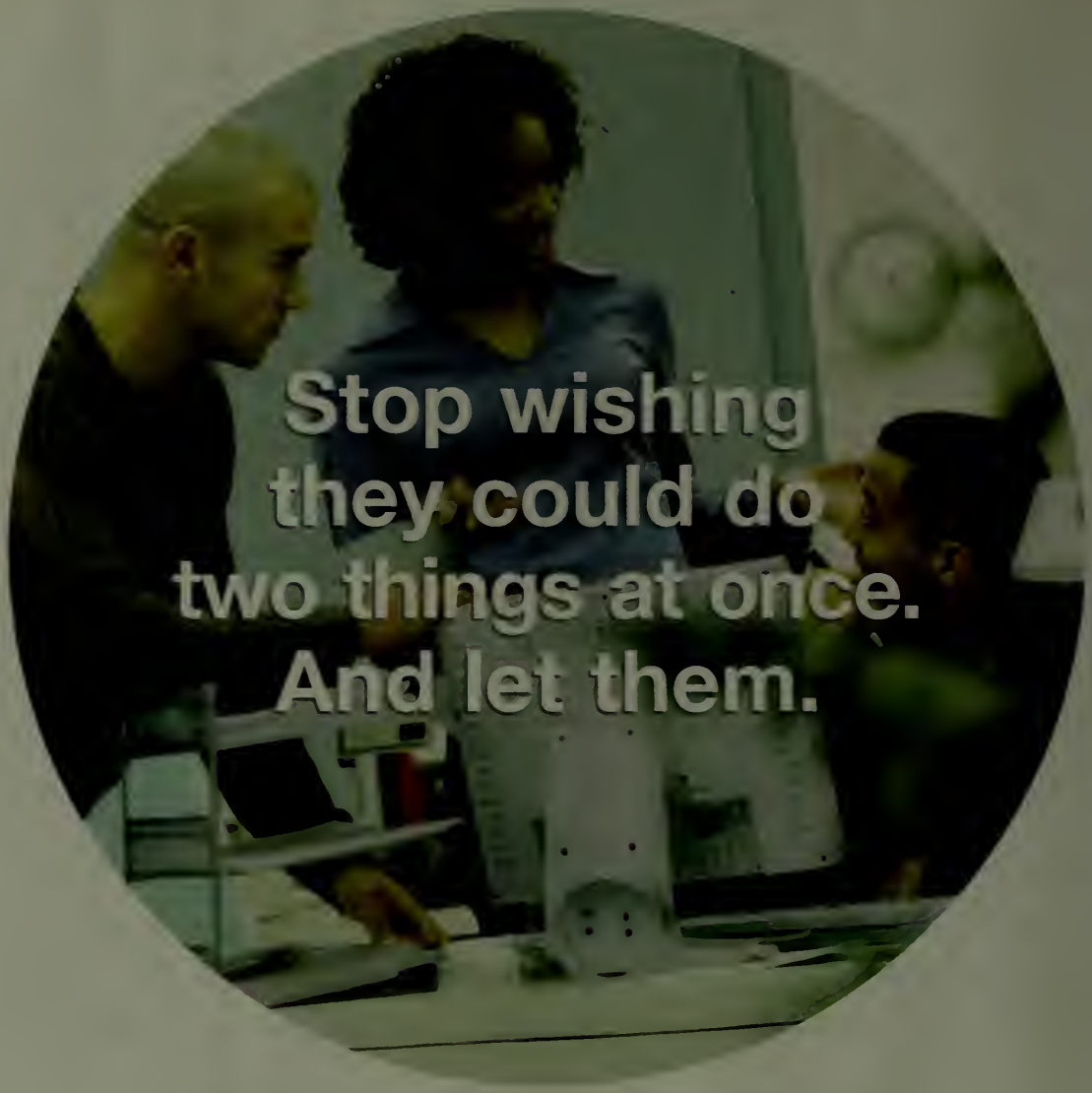

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ITED BY ROSE BRADY

Egypt Starts Planning For Life After Mubarak

ESIDENT HOSNI MUBARAK'S absence from Egypt since June 20 for ck surgery in Munich has sent shock waves through the yptian Establishment. Mubarak, 76, has ruled Egypt since the assination of Anwar Sadat by Islamic militants on Oct. 6, 81. Once considered a caretaker, the stolid former Air Force mander has lasted in office nearly a rter of a century. No wonder his absence set off rumors that he is gravely ill. His er having named a successor adds to the st. "With the President's surgery, the e [of succession] is more pressing than time before," says Abdel Monem Said director of the Al-Ahram Center for tical & Strategic Studies in Cairo.

he prospect that the Mubarak era ht be drawing to a close is both an op- tunity and a worry for the Arab world's est country. It's an opportunity because conservatism of Mubarak's twilight rs has stifled badly need- change. While Egypt has arliament and elections, leaders aren't account- e to the public, and barak's economic man- ment has been third rate. pt's living standards e declined in recent rs. Yet Mubarak's possi- departure is stirring rry because it could trig- a destabilizing battle ong factions eager for the ils. "I am not opti- stic," says Mohamed Sid- med, a columnist for the ro newspaper *Al-Ahram*. am afraid we are sinking vard chaos." A power vac- m is cause for concern because the coun- plays a pivotal role in the Mideast.

Recently, Mubarak has taken measures t are seen as preparations for his even- l departure. He transferred autocratic ormation Minister Safwat al Sherif to a emonial post and signaled that a bigger binet shuffle is on the way. The victims likely to be Old Guard figures such as erif, whom the press blames for block- reforms proposed by younger members of the ruling National Democratic Party (NDP), increasingly dominated by Mubarak's son, Gamal. "The transition process has already begun," says a businessman in Cairo. "Everybody is positioning themselves on how to handle it."

OUT OF THE OFFICE Mubarak is in a Munich hospital with back woes

Sign of Backwardness?

YOUNGER MEMBERS of the business community would like to see Gamal, 41, succeed his father. They hope the former Bank of America exec would push for market-oriented reforms. But many Egyptians feel it would be a sign of backwardness for the President's son to follow him. Other names circulating include intelligence chief Omar Suleiman, Mubarak's troubleshooter with the Palestinians and Israelis. A lesser-known possibility is Alexandria Governor Abdel Salam al Mahgoub, known for innovative development projects.

The outcome will depend on how Mubarak decides the next President should be chosen. He was vice-president when he succeeded Sadat but has always resisted picking a No. 2. Pundits speculate Mubarak may finally tip his hand before or during a September ruling party conference. If he chooses a vice-president or looks for consensus among the military and bureaucracy, Gamal is unlikely to emerge on top because he is viewed as lacking sufficient credentials. Some analysts hope Mubarak will make a bold gesture and change the constitution to allow direct elections—a move that might favor Gamal. With other parties weak, the NDP would be a formidable force during this key transition period for Egypt. ■

–By Stanley Reed in London

GLOBAL WRAPUP

YOUNG BLOOD AT SIEMENS

GERMAN ELECTRONICS conglomerate **Siemens** has sent a strong signal about its future direction by naming Klaus Kleinfeld to succeed Heinrich von Pierer as CEO, effective in January, 2005. Kleinfeld, 46, belongs to a younger generation of managers who are likely to speed Munich-based Siemens' transition to a leaner, more profit-oriented company. Although $89 billion Siemens has remained profitable during the economic downturn, its margins have been squeezed.

Already, Siemens has taken a harder line with its well-paid German workers, pressuring some units to put in longer hours for the same pay. Expect more of that kind of thing from Kleinfeld, former chief of Siemens in the U.S. But Kleinfeld must take care to avoid all-out war with labor. That still doesn't fly in consensus-oriented Germany.

RUSSIA'S NERVOUS BANK DEPOSITORS

FEARS ARE GROWING that Russia is on the verge of a full-scale banking crisis, after **Guta Bank,** Russia's 22nd-largest bank in terms of assets, closed its doors on July 6 following a run on deposits. The shutdown comes after weeks of instability, which began in May when the Central Bank withdrew the license of mid-tier Sodbiznesbank, accused of money laundering. Now the crisis is spiraling. Even Russia's No. 1 privately owned bank, **Alfa Bank,** was forced to deny solvency problems after depositors mobbed branches. Central Bank Chairman Sergei Ignatiev says depositors at Alfa and other big banks have nothing to fear. But he has slashed banks' reserve requirements, just in case.

Big Brown's New Bag

UPS aims to be the traffic manager for Corporate America

FOR YEARS, THE BANE OF most Ford dealers was the auto maker's Rube Goldberg-like system for getting cars from factory to showroom. Cars could take as long as a month to arrive—that is, when they weren't lost along the way. And Ford Motor Co. was not always able to tell its dealers exactly what was coming, or even what was in inventory at the nearest rail yards. "We'd lose track of whole trainloads of cars," recalls Jerry Reynolds, owner of Prestige Ford in Garland, Tex. "It was crazy."

But three years ago, Ford handed its byzantine distribution network to an unlikely source for an overhaul: United Parcel Service Inc. In a joint venture with the carmaker, UPS engineers, with input from Reynolds and other dealers, redesigned Ford's entire North American delivery network, streamlining everything from the route cars take from the factory to how they're processed at regional sorting hubs. Ultimately, UPS deployed a tracking system similar to the one it uses to monitor 13.8 million packages daily—right down to slapping bar codes on the windshields of the 4 million cars rolling out of Ford's 19 North American plants each year and onto railcars.

The result: UPS has cut the time it takes autos to arrive at dealer lots by 40%, to 10 days on average. That saves Ford millions in working capital each year and makes it easy for its 6,500 dealers to track down the models most in demand. (General Motors Corp., by contrast, uses a proprietary online system for distribution; Chrysler Corp. contracts with Union Pacific Corp.) "It was the most amazing transformation I had ever seen," marvels Reynolds. "My last comment to UPS was: 'Can you get us spare parts like this?' "

Welcome to the new UPS. Ever since its humble beginnings in 1907 as a Seattle messenger service, the real story about UPS is how this traditionally insular and conservative enterprise has managed to reinvent itself time and again to keep growing. No matter how fearful the next step might have seemed, UPS took it. Back when the telephone became a household staple, founder James E. Casey remade his messenger service into a home delivery business for retailers. When Americans began buying cars and driving their purc home, UPS reinvented itself again, fig scores of legal battles so that its fleet compete with the U.S. Postal Service

Those moves have helped make into the colossus it is today. Last yea Brown earned $2.9 billion on $33. lion in revenues. And its stock, at $74, has outperformed the market the company went public in Nove 1999. Since then, UPS shares have g ated total shareholder returns of compared with a negative 12% retu the Standard & Poor's 500-stock inc

FAST-FLOWING STREAM

TO KEEP UP THE momentum, U undergoing its latest makeover. Wi U.S. delivery business maturing company has been working feverisl transform itself into a logistics ex Last year, that end of the busines counted for $2.1 billion in revenue just 6% of the UPS total. But analyst lieve logistics could provide a poten huge new revenue stream—up to 20 future growth by some estimates. Si put, UPS wants to leve decades of experience r aging its own global d ery network to serve a traffic manager for Co rate America's sprav distribution networks- ing everything from sc uling the planes, trains ships on which goods r to owning and mana companies' distribu centers and warehouses. Just as im tant, says UPS, is that its strategy sh also generate additional delivery b ness for its ubiquitous brown trucks private air fleet. The pitch to custon Let us manage the supply chain, w you focus on core marketing and pro

> UPS is set to book ships and run warehouses for others

Fleet Feet

Thanks to the growing UPS logistics business, Birkenstock has slashed the time it takes to get its shoes from factories in Germany to U.S. stores. A trip that once could take seven weeks—through the Panama Canal—now takes three.

1 At plants in St. Katherin and Alsa, German Birkenstocks are packed in crates and bar-coded with their final U.S. destination.

2 UPS trucks the crat Rotterdam, where t into cargo containers fo transatlantic voyage.

ESKEW says UPS osts customers' sh flow, service, d productivity

elopment. That way, says CEO hael L. Eskew, 55, UPS can help com- ies "improve their cash flow, their omer service, and their productivity." he shift in focus is not without risks UPS. Contract logistics is historically a er-margin business than package de- ry. Analysts estimate that the compa- operating margins in logistics are 5% overall. Although large-scale sulting contracts can be quite prof- le, bread-and-butter work like ght-forwarding, managing warehouses, or order fulfillment can earn as little as 2%. Margins on the company's core delivery business, on the other hand, hover around 15%. "The dilemma with logistics is that it offers high revenue growth, but if you aren't careful, minimal profit growth," warns Morgan Stanley analyst James Valentine.

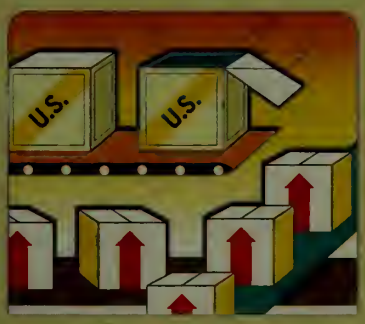
Some big rivals question whether UPS can generate enough additional delivery business to justify its foray into logistics. "The contract logistics business is fundamentally low margin," says FedEx Corp. Chairman Frederick W. Smith. "And I'm not sure the fundamental premise—that it will result in you getting more profitable small-shipment business—is correct."

OUTRUNNING THE TRUCKS

BUT UPS MAINTAINS it is already seeing such a payoff. Indeed, some analysts estimate that in 2003 UPS used logistics to snag an extra $2 billion in shipping volume. UPS execs also maintain that because logistics is far less capital-intensive than the delivery business—with its heavy investments in trucks, airplanes, technology, and real estate—logistics has a high return on investment. And they contend that the margins will improve as the business grows.

For now, UPS is taking on more and more contracts where its brown trucks aren't involved—or where they come into play only at the end of the journey. Consider its deal with Birkenstock Footprint Sandals Inc. UPS contracts with ocean carriers to get shoes made in Germany across the Atlantic to

s arrive in Newark, N.J. clears them through and trucks them to its arby Carteret.



4 Minutes after arriving, the containers are opened, shoes sorted, and brown trucks speed them to any of 3,000 stores.

5 Along the way, UPS uses barcode scanning to keep track of every shipment until the merchant signs off on it.

New Jersey ports, instead of routing them through the Panama Canal to the shoemaker's California warehouses. Each incoming shipment is whisked away to a UPS distribution hub and, within hours, to retailers (table, page 54). By handing over its keys to UPS, Birkenstock has cut the time it takes to get shoes to stores by half, to just three weeks. "Our spring fashion merchandise shipped 100% on time—and it was the first time in history I've been able to say that," says Birkenstock's chief operating officer, Gene Kunde.

ONLINE ORDERS

IN FACT, THERE SEEM to be few tasks UPS won't undertake to embed itself with customers. For Jockey International Inc., UPS not only manages a warehouse but also handles Internet order fulfillment. Apparel bought on the Jockey Web site is boxed for shipping by UPS warehouse staffers and delivered by UPS drivers. And if there's a problem, calls are handled by UPS phone reps. Big Brown also handles laptop repairs for Toshiba America, installs X-ray machines in Europe for Philips Medical Systems, and dresses Teddy bears for TeddyCrafters.

The UPS move is partly defensive. Today a growing breed of consultants uses sophisticated computer programs to help corporate clients negotiate aggressive shipping discounts. And shipping rivals such as Deutsche Post, with its DHL unit, are aggressively moving into logistics. In recent years, DHL and FedEx have nibbled away at the UPS domestic ground business—since 1998, its market share has shrunk from 57.7% to 56.9%. "We had a legitimate fear of becoming a commodity and having other providers deal with our customers," says James P. Kelly, who retired as the CEO of UPS in 2001 but remains a director. "If we didn't do it, someone else was going to."

BRANCHING OUT In Louisville, UPS repairs laptops for Toshiba America

Logistics represents a personal crusade of sorts for Eskew. A UPS careerist, he began formulating such a move several years ago when he served as head of strategic planning. But it wasn't until a management retreat in early 2002, where senior executives were pondering whether the company needed to expand into manufacturing or some other field to sustain its long-term growth, that Eskew convinced them that logistics was the answer. But doing it well, cautioned Eskew, would force UPS to reinvent itself yet again. "We can play a significant role [in logistics], but we will have to change ourselves," he said.

Since the year 2000, UPS has spent more than $1 billion to buy 25 companies involved in freight-forwarding, customs clearance, finance, and other logistics services. Eskew pulled some rising UPS stars from its ma delivery operations on to his new su chain team. And in parture from the cau UPS culture, E pushed managers to risks—counseling failure wasn't irrepa as long as you "fail and fail small."

To its credit, UPS learned how to keep small failures from ting bigger. Accordi former executives, a deal to acquire San I cisco's Fritz Cos., a fr forwarder that cont with various carrie help companies r goods, didn't go smoo

After Fritz's entrepreneurial sta clashed with by-the-book UPS mana many left. That led to the defection o customers like giant Costco Whol Corp. But in time, UPS stabilized F operations, installed some of its managers, and lured back clients: Co began using UPS freight-forwar again earlier this year.

Eskew can now turn his attentio convincing the rest of Corporate Am that UPS isn't just about parcels anym It's the missing link that can make supply chains stronger. And if that also helps UPS lock up their ship business, so much the better. ■

–By Dean Foust in Atl

BusinessWeek online For a Q&A with UP Chief Executive Michael Eskew, go to www.businessweek.com/magazine/extra

Adapt or Perish

Time after time since its founding in 1907, UPS has reinvented itself to stay one step ahead of extinction.

DIAL "D" FOR DELIVERY In 1913 the telephone threatened to kill off the original UPS messenger business. Founder James Casey switched to contracting with retailers to deliver customer purchases. The first ones got to their destinations in a Model T Ford.

CARRY THAT FOR YOU? After World War II, more shoppers took purchases home in their cars. In 1952, UPS opened legal battles, ultimately successful, to vie with the U.S. Postal Service and become a "common carrier" delivering to individuals and businesses.

ALOFT, AT LAST In 1985, years after FedEx showed that shipping packages overnight by air was a viable business, Big Brown responded by starting its own overnight a service. Today, UPS owns or charters nearly 600 aircraft.

THE VIRTUAL PACKAGE By the mid-1990s plain-vanilla parcel delivery was a mature business in the U.S. So UPS boosted its investment in technology to get into logistics services. Today it handles everything from financing to storage and tracking of shipments.

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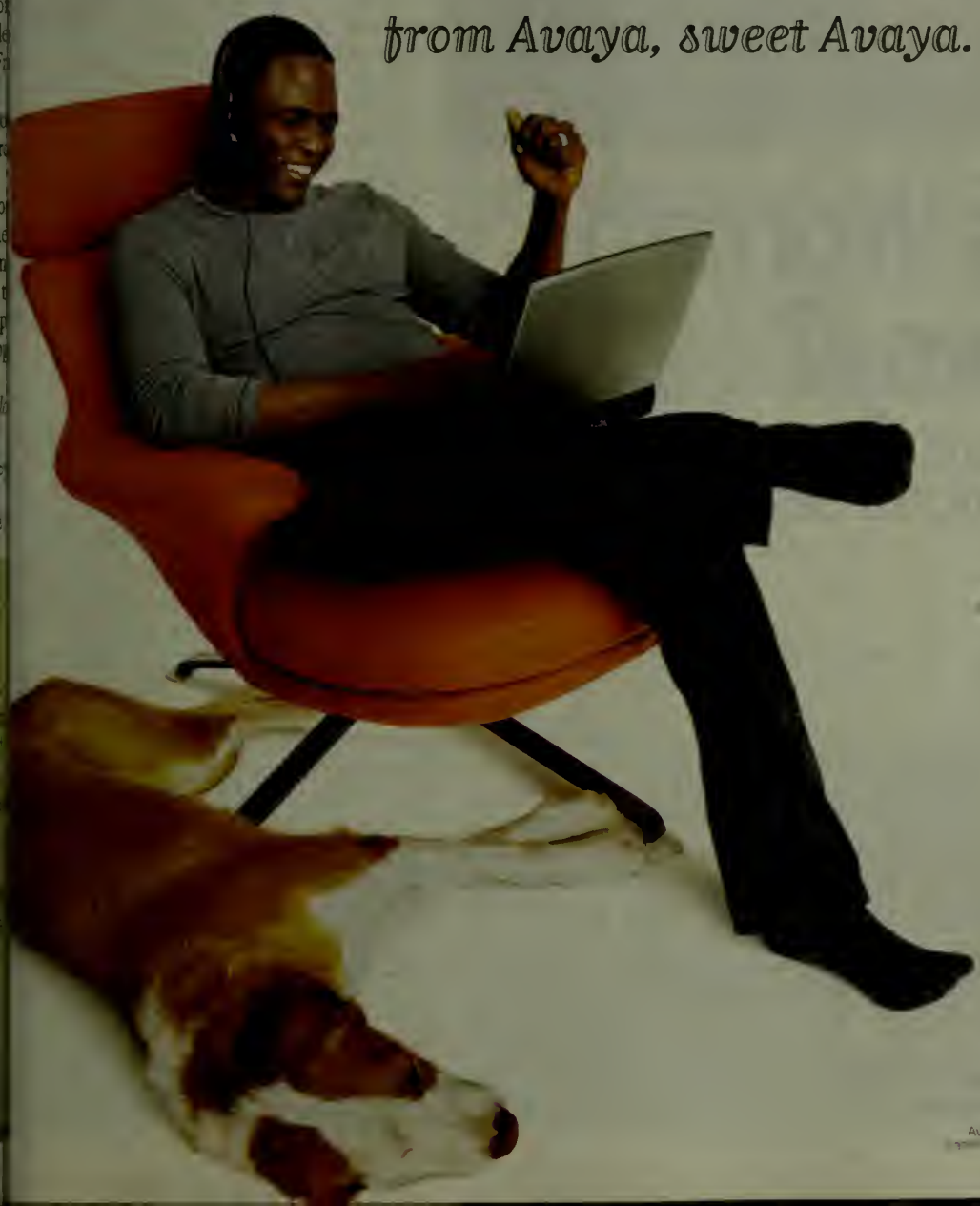

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'BOOTSTRAPPER' Hartman started *N'Digo* in 1989 with $3,000

Can This Woman Save *Savoy*?

Hermene Hartman's acquisition could put her in the top tier of black publishers

IN MID-MAY, HERMENE D. Hartman glimpsed a window of opportunity. *Savoy*, recently billed as the hottest national magazine for black professionals in decades, had just been bought in a bankruptcy auction for $375,000. Hartman missed the auction but saw *Savoy* as a perfect complement to her free Chicago newspaper, *N'Digo*, which also targets upscale blacks.

So she phoned the buyer, New York's four-year-old Jungle Media Group. Hartman figured her black publishing background was better suited to remake *Savoy* with the right "feel and flava." So she offered $600,000—from personal savings and loans—enough to give Jungle a comfortable profit but less than the monthly was worth to her. Deal done.

It's a big job: Reinventing a bankrupt national magazine

It will be a tough turnaround for the 56-year-old regional print queen. Hundreds of new magazines are launched every year but the majority never make it to a fifth anniversary. Re-launching an existing title is no easier. *Savoy*, which made its debut in 2001, proved to be a feisty upstart, boosting its ad revenue from $6 lion in 2002 to million in 2003 a a tough ad ma Still, the 325,000 culation magazine slipped into bankr cy last fall after publisher Vanguarde dia ran short of cash.

Hartman is looking beyond *Savoy'* cent troubles. She sees a lot of potentia ue in the magazine, particularly since nicely within her publishing niche. crafting a business plan, Hartman will $5 million to $10 million from venture italists this summer. That funding, says, will help expand readership 500,000 in three years. The idea is t less tied, as *Savoy* was, to bookstore n stands, where visibility is minimal. H mans wants to lure more subscriber selling at black neighborhood venues cluding churches. "We didn't have a b *Vanity Fair*," says Ken Smikle, preside audience researcher Target Market N Inc. "That's one thing *Savoy* provided.

And Hartman is counting on pen demand from advertisers. While ad p for all magazines slumped in 2003, Target Market News, the top eight b publications, including *Savoy*, saw an rise. To woo more advertising, Hart will explore pairing *Savoy* with a new tional quarterly published by *N'Digo* will profile black luminaries. She will p fee to insert the mag in big-city new pers such as *The Washington Post* and the ad revenues for herself.

TOUGH TEST

A "BOOTSTRAPPER," as Hartman herself, the flamboyant niece of the crooner Johnny Hartman likes a c lenge. In the late 1980s, she read *El* founder John H. Johnson's book, *Succ ing Against the Odds*. Then a City Colle of Chicago administrator with no p lishing experience, she decided to the odds and launched *N'Digo* in 1 with $3,000. The free tabloid has gr from a 50,000-circulation monthly to nation's largest black weekly newspa with a circulation of 150,000 and $3 lion in annual ad revenues.

Hartman's scarce experience on national stage will make Savoy a diffi test. But if she succeeds by giving Sa that right feel and flava, she might find herself in the company of the b publishing giants who inspired her.

–By Roger O. Crockett in Chi

BusinessWeek online For a Q&A with publisher Hermene Hartman, go to www.businessweek.com/magazine/extra.

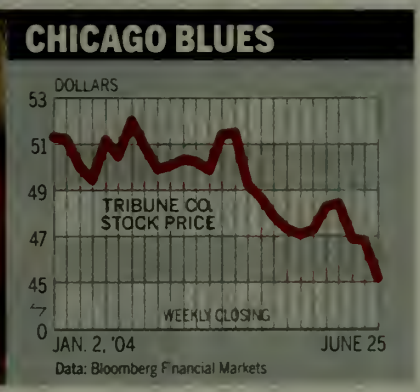
Vrestling with rib Co.'s Demons

n CEO FitzSimons exorcise a rculation scandal and an ad slump?

DENNIS J. FITZSIMONS has had better months. First, the normally genial chief executive of Tribune Co. had to explain troubling staff cuts at the *Los Angeles Times*, where a ch of Pulitzer Prizes couldn't stave off nexpected slump in ad growth. Then e the nasty circulation scandal at the pany's fast-growing Spanish-lan-ge national tabloid, *Hoy*, and Long Is--based *Newsday*. Finally, a Philadel-ı appeals court tossed into limbo the t of FitzSimons' company to own TV stations and newspapers in such ial spots as Los Angeles and New c. And all that was just in June.

ighteen months into his job as CEO of une, the 54-year-old former TV ad-ising salesman is taking a stoic view he toughest challenges he has faced n a 22-year career at the Chicago out-He's hanging tough even as the stock guishes below 45, off 15% from its re-t high in February. "Sometimes these gs come your way," says FitzSimons. d it's how you deal with them that de-nines your success or failure." Putting harper edge on it, A.G. Edwards & Sons analyst Michael A. Kupinski says it's crunch time for FitzSimons, noting that he'll have to "really show his leadership."

The embattled FitzSimons is moving fast. To wrestle down the most nettlesome problem, circulation woes, he is setting up new audit systems at all 14 of the company's daily newspapers, including requirements that circulation executives sign off on periodic reports, much as CEOs do now under Sarbanes-Oxley. With 80% of Tribune's revenues coming from advertisers, he says, he cannot permit the overstatements to cast doubt on Tribune's honesty.



The inflated numbers, which advertisers relied on to buy ad space, are anything but trivial. Even as Tribune investigates the misstatements—with one circulation executive already put on leave—*Newsday* has sliced 40,000 copies a day off its reported daily circulation, about 7% of the total for last year. It also cut 60,000 copies, or 9%, of its Sunday papers. *Hoy* has slashed 15,000 daily and 4,000 Sunday copies, 16% and 12% of the tabloid's numbers, respectively. Now advertisers will likely want to be made good for overpayments based on the false numbers. At Newspaper Services of America, a media buying firm, CEO S. Scott Harding gives FitzSimons high marks so far, but he is still holding the CEO's feet to the fire. Says Harding: "The final litmus test will be the resolution to the advertisers."

RETAIL REVERBERATION

LATELY ADVERTISERS are a big worry for FitzSimons. Based on a sudden hiccup in ad growth, mainly because of weakness in the struggling Southern California economy, he's now warning Wall Street that Tribune's prediction of 6% revenue growth this year, from 2003's $5.6 billion, was too optimistic by at least two percentage points. Newspapers account for more than two-thirds of Tribune's revenues, with 30% of that from the *Los Angeles Times* alone. Sales "hit the wall" there in May, says Tribune Publishing unit President Jack Fuller, dragging down the others.

FitzSimons can point to fresh signs of life in ad sales in Los Angeles, but he is still cutting costs in the wake of a change in ad-buying patterns after a spate of retailer consolidation in Southern California. He has eliminated roughly 200 jobs—60 from the newsroom—cuts that have gone down hard since they came just months after

Tribune's Weak Link

he newspaper roup earns 2% margins, . 34% for TV nd entertainment

NEWSPAPERS *L.A. Times* yields 30% of publishing revenues, and ads in May "hit the wall"

BROADCAST Fat margins, but growth is slowed by unsettled "cross-ownership" rules

BASEBALL The salaries of stars such as Sammy Sosa haven't hurt the Chicago Cubs' profitability

the paper had won five Pulitzer Prizes.

Despite the skimpier profitability, FitzSimons insists that Tribune remains committed to newspapers, even if the the company's 26 TV stations are much more lucrative. The newspaper division reports margins of 22%, vs. 34% for the broadcasting and entertainment group, despite the fat salaries commanded by players such as Sammy Sosa at the Tribune-owned Chicago Cubs and the costs of such new programming as *Sex and the City* reruns. Unlike TV viewers or Web surfers, newspaper readers want to see advertising, says FitzSimons. And he insists the recent woes should not stir new doubts about Tribune's 2000 acquisition of Times Mirror Co., which brought it the *Los Angeles Times* and *Newsday*. "Having scale is an advantage," the CEO argues.

But broadcast is crucial for Tribune. FitzSimons, craving more stations, is frustrated by a June 24 decision by the U.S. Court of Appeals in Philadelphia. The court said that the FCC could let companies own both TV stations and newspapers in single markets, as Tribune does in New York, Los Angeles, Miami, and Hartford. But the judges want the FCC to draw up new rules, which they want to review. For FitzSimons it's an unwanted delay, and he vows to go to the Supreme Court, if needed, to get the so-called cross-ownership rules set.

Layoffs came soon after the *L.A. Times* won five Pulitzers

Perhaps luckily for FitzSimons, buying is not on his immediate agenda. Citing high prices for TV stations, he plans to use spare cash to buy back more Tribune stock—$750 million worth or more over time, which could give the share price a much-needed boost (chart).

The financial payoff of Tribune's newspaper-TV consolidation drive seems a long way off, much as in other big-media mergers. And now, FitzSimons has the extra burden of repairing Tribune's damaged reputation along with shoring up revenues and profits. Those are headlines no one in the news business wants to be making. ■

–By Joseph Weber in Chicago

BusinessWeek online For a Q&A with Tribune Co.'s Dennis FitzSimons, go to www.businessweek.com/magazine/extra.htm

From Plunderer To Protector

In a new documentary, Interface's Ray Anderson discusses his green epiphany

SIX MINUTES INTO THE new business-slamming documentary, *The Corporation*, an imperial-looking CEO flashes onto the screen. The lines of his suit are crisply creased, his hair freshly snipped. A classic black background frames the scene as he speaks in the sumptuous baritone befitting a modern industrialist. Sitting in the audience, you sense the executive must be in for a *60 Minutes*-style scorching. After all, *The Corporation*, the latest in this summer's barrage anti-Establishment documentaries, gues that companies fit the clinical d inition of psychopaths: self-absorb deceptive, and incapable of mainta ing enduring relationships.

But the man in the starched shir Ray C. Anderson, founder and n chairman of Atlanta-based Interf Inc., the world's largest manufacture commercial carpet tile. Instead of be portrayed as the unrepentant spewe greenhouse gases that the publi traded company once was, Interface

RED VIEWING? rson says all should see *Corporation*

well as Anderson, turn out to be *The Corporation*'s heroes. "I realized the way of the CEO is ay of the plunderer," Anderson says stares into the camera, recalling his le-old epiphany. "Someday people ne will go to jail."

e Canadian-produced film, which the World Cinema Documentary ence Award at the Sundance Film val and opened on June 30 in hattan, argues that multinationals modern life what the Church was e Middle Ages: monolithic institu- that self-righteously pursue their das. Companies are unsustainable m machines" that create great th but also great harm. By sanction- heir free rein, the film posits, socie- practicing intergenerational tyran- Let the kids clean up the mess.

WERFUL VOICES"

PLAYS IN ART HOUSES across the try this $2-a-gallon summer, many ve *The Corporation*'s message will nate. Sentiment toward business is cord lows, according to Paul A. Ar- i, a professor at Dartmouth College's Tuck School of Business who has studied the issue for 20 years. "Enough people with powerful voices are out there arguing about this stuff that it's something companies and CEOs need to think seriously about," says Argenti.

Making appearances are left-wing pundits such as Noam Chomsky, Michael Moore, and Howard Zinn, as well as free-market heavies such as former Goodyear Tire & Rubber Co. CEO Sam Gibara, management guru Peter F. Drucker, and conservative economist Milton Friedman. But it's Anderson who is the movie's mahatma.

The story of his transformation from Bentley-driving industrialist to earth-embracing hybrid evangelist (he's on his second Toyota Prius) began 10 years ago at Interface's Atlanta headquarters. Interior designers peppered the company with questions about the dangers in the materials and processes it was using.

At the time, environmentalism was a foreign language to Anderson. So he convened a task force to answer his customers' questions. The members then turned around and asked him to deliver a speech to the company on his environmental vision. "But I had no vision, absolutely none," he says.

He searched desperately for inspiration and found it in the form of Paul Hawken's *The Ecology of Commerce: A Declaration of Sustainability.* The book argues that most manufacturing companies gnaw through the earth's limited resources without regard to the poisonous legacy they often leave behind. "It was like a spear in my chest," Anderson recalls. "That's the way I had been running my company. Taking something that wasn't mine."

He pledged that, by 2020, Interface would be a completely sustainable company, producing no dangerous waste, no harmful emissions, and using not a drop of oil. So far, the company is a third of the way there (table).

Does Anderson agree with the filmmakers that companies are psychopaths? "I think they had a thesis and used extreme examples to prove it," he says diplomatically. Do companies have too much power? "Probably," he hedges. Should CEOs see the film? Here, he's emphatic. "Absolutely." *The Corporation* is a mirror, he says. The point for CEOs, he adds, is to see if they recognize themselves in it—and, if they do, to change. ■

–By Michelle Conlin in New York

BusinessWeek online For a Q&A with Interface Chairman Ray Anderson, go to www.businessweek.com/magazine/extra.htm

nterface's co-scorecard

lecade ago, Interface founder y Anderson pledged that his 24 million company would p using the earth's natural ources, eliminate waste, and it no harmful emissions by 20. Some of the reductions it s made so far:

WASTE	↓ 80%
WATER INTAKE	↓ 78%
EMISSION OF GREENHOUSE GASES	↓ 46%
ENERGY CONSUMPTION	↓ 31%
USE OF PETROLEUM-BASED MATERIALS	↓ 28%
TOTAL SAVINGS	$231 million

Data: Interface Inc.

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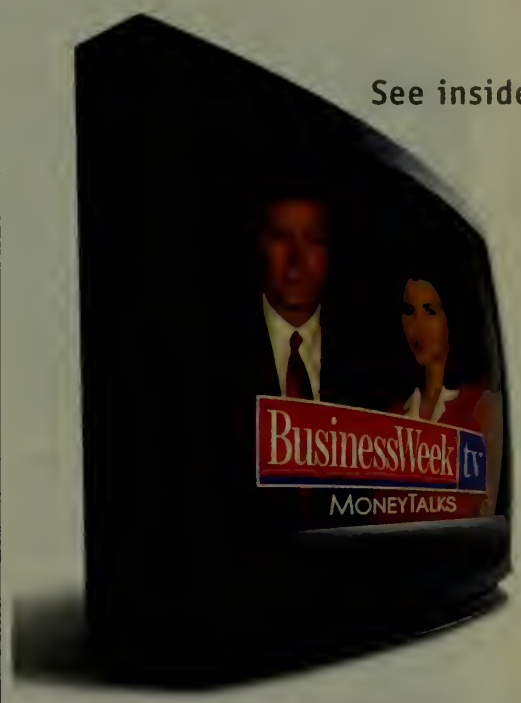

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The McGraw-Hill Companies

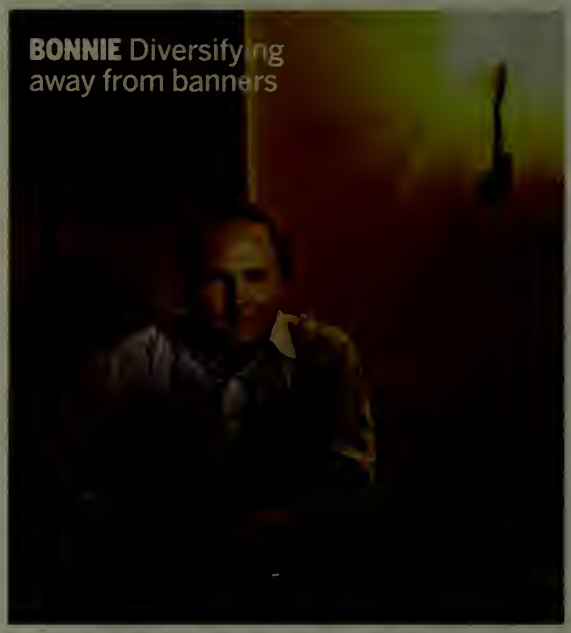
Is CNET's New Ad Strategy a Sizzler?

The online publisher's focus on building brands should boost the bottom line

FORGIVE SHELBY W. BONNIE if he feels left out of the party. First, he took over as CEO of online publishing company CNET Networks Inc. in March, 2000, just as the tech bubble burst. Then while the resurgence in online advertising over the past two years led to soaring revenue growth for Web cohorts Yahoo! and Google, CNET continued to struggle. Why? CNET's bread and butter is selling Web banner ads, a business that has been on the decline for three years. The company largely missed out on the fastest-growing slice of the online ad market—the search-engine bonanza that has benefited Yahoo and Google.

Now, finally, Bonnie may have his chance to celebrate. Strength in the overall Net ad market and CNET'S success with new kinds of Web ads have prompted the chief executive to raise his guidance for 2004 revenue to a range of $280 million to $285 million, up from $246.2 million last year. As a result, analysts expect CNET to report net income of $11.5 million this year, the first time the company will have recorded a full year of profits since 1999. "They're doing well," says Jeffrey L. Dearth, a partner at investment bank DeSilva & Phillips LLC. "Ask the print publishers in this space, and they would be delighted with the growth CNET is seeing." The company's stock has doubled in the past year, to about $10.

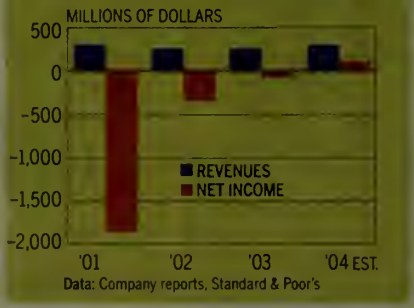
Bonnie is betting on a strategy with much promise for the years ahead. He believes that companies increasingly will use the Net to build their brands. Instead of simply paying for text links alongside search results on, say, Google, advertisers will want to polish their brand names with the kind of multimedia ads they run on television and radio. And he figures the content on CNET's collection of sites will make them prime destinations for that kind of marketing, particularly as Net advertising becomes more interactive. Already, BMW, Honda Motor, and McDonald's are doing brand advertising on its sites. "Advertisers are turning to online brand development and more innovative spots that can build excitement about their products," says Bonnie. "We see tha 10-year trend of dollars moving into t dustry, and it will be a lot more than w spent on [search] marketing."



BONNIE Diversifying away from banners

EXTRA! EXTRA!

CNET is expected to move into the black in 2004 after years of losses



Data: Company reports, Standard & Poor's

Bonnie has put together an impre group of offerings to attract Web s and advertisers. CNET's Reviews ch is one of the most comprehensive and consumer-electronics evalu destinations on the Internet. GameS a similar site for video- and comp game enthusiasts. News.com is a fledged tech-news operation. And recently reopened MP3.com as a one digital-music site where surfers can reviews and legally buy songs providers such as Apple Compu iTunes Music Store and Roxio's Na *BusinessWeek* has a partne with CNET for online conten

To take advantage of those CNET is pushing the env with new types of ads. At the pany's GameSpot, for inst visitors could see a video cli the latest *Grand Theft Auto* and then click on a link to demo version. At News.com, ers of tech software can plug own figures into a spreadshee calculate their return-on-in ment estimates. "CNET is off much more interesting wa brand your product today Google," says Rishad Tobacco executive vice-president a agency Starcom MediaVest G

For some companies, that proach seems to be working. ads have boosted direct referr Sony Corp.'s e-commerce Web site 225% since the beginning of last ye cording to Patrick Vogt, a senior vice- ident at Sony's direct-sales arm. Now, is spending 30% of his online adverti budget on CNET.

How successful CNET is will depen whether the online ad market develop way Bonnie expects. He thinks Net a tising eventually will look like the t tional ad market, in which over 80% o money is spent on brand-building only a sliver goes to direct marketing. job is to grow our properties to get a of those dollars so we're in a positi capture them over time," he says. If happens, Bonnie will have even more son to celebrate. ■

–By Alex Salkever, with Ben in San Mateo,

BusinessWeek online For a Q&A with CNET CEO Shelby Bonnie, go to www.businessweek.com/magazine/extra

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THE BENEFITS

BY NANETTE BYRNES

Old-line companies have pledged a trillion dollars to retirees. Now they're struggling to compete with new rivals, and many can't pay the bill.

JUNE 28 WAS THE DAY HOPE RAN OUT FOR UNITED AIRLINES' 35,000 retirees. That was the day the government announced it would not guarantee the bankrupt airline's loans—virtually assuring that if UAL Corp., the airline's parent, is to remain in business it will have to chop away at expensive pension and retiree medical benefits. The numbers are daunting. UAL owes $598 million in pension payments between now and Oct. 15, and a total of $4.1 billion by the end of 2008, plus an additional $1 billion for retiree health-care benefits, obligations the ailing airline can't begin to meet. And if United finds a way to get out of its promises, competitors American Airlines, Delta Air Lines, and Northwest Airlines are sure to try to as well.

UAL workers are about to find out what other airline employees already know: The cost of broken retirement promises can be steep. Captain Tim Baker, a 19-year veteran of US Airways Inc., was one of several union representatives sorting through that airline's complicated bankruptcy negotiations in March, 2003. Of the airline's many crises, the biggest was the pilots' pension plan, a sinkhole of unfunded liabilities. Baker reluctantly agreed to back US Airways' proposal to dump the pension plan on the Pension Benefit Guaranty Corp. (PBGC), the government agency that is the insurer of last resort for hopelessly broken plans. It's a move that practically guarantees that retirees will receive less than they were promised, in some cases less than 50¢ on the dollar. But of a raft of bad options, it seemed the only one that could keep the company afloat. "It was the pension underfunding and its future requirements that were going to put in jeopardy the airline's ability to get out of bankruptcy," says Baker. "At some point you have to around and say that is all there is."

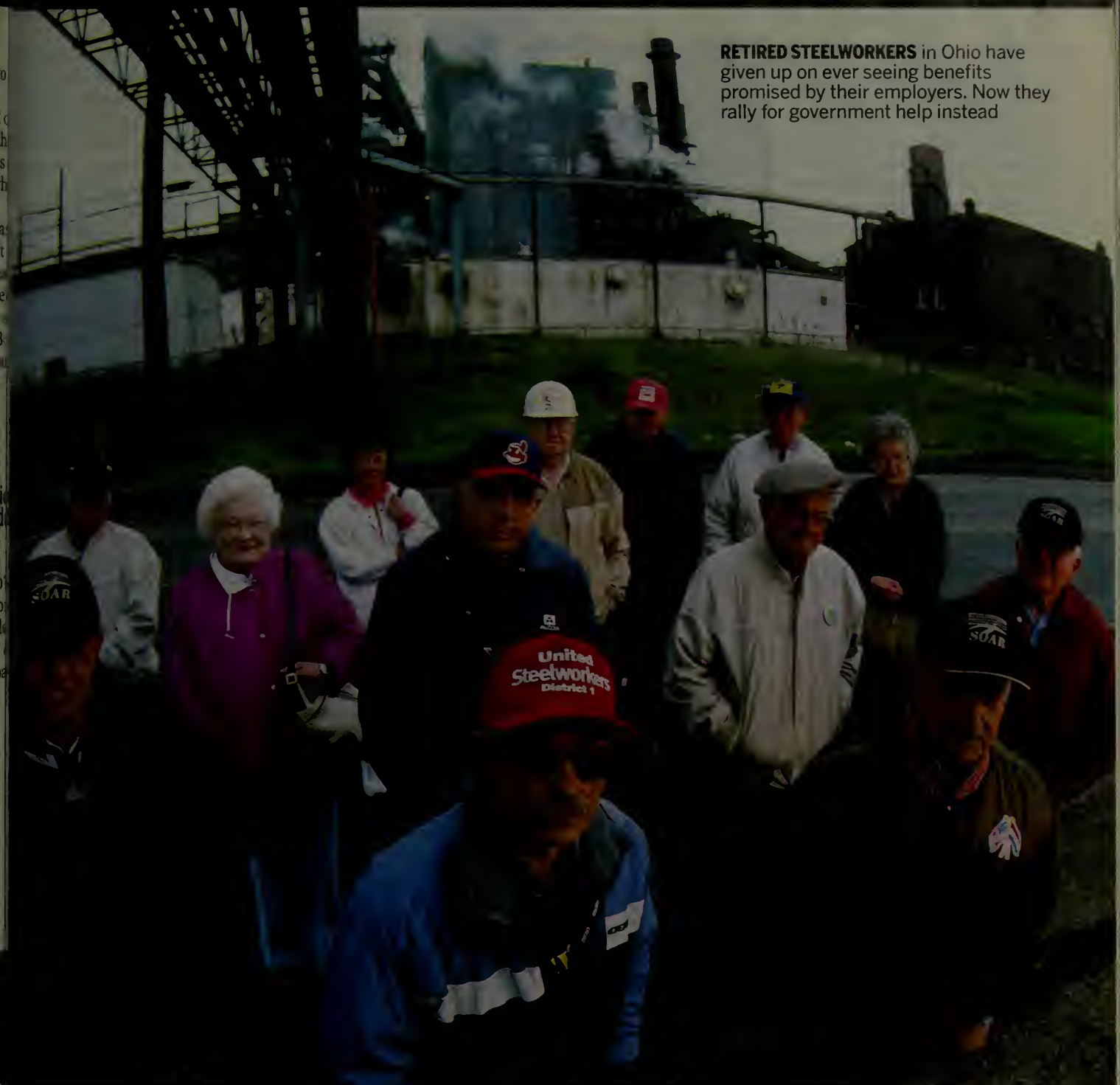
Baker has paid dearly for that decision. He was voted his union position by angry fellow pilots and instead of th figure annual pension he was promised, when he retires years he'll get just $28,585 a year from the PBGC, plus wh er he can save in his 401(k).

Stories like Baker's are becoming dreadfully common a ployers faced with mounting retiree costs look to get out under. It's not just troubled industries like airlines th abandoning their role as retirement sponsors to Ame workers, either. The escalating cost of retirement plans is ical issue at a range of long-established companies from B to Ford Motor to IBM, many of which compete against yo companies with little or nothing in retiree costs.

SHIFTING THE RISK

» As employers abandon ever-more-costly traditi retirement plans, the burden is falling on individ and taxpayers

WHY ARE RETIREES BEING LEFT OUT IN THE COLD unsavory brew of factors have come together to put stress o retirement system like never before. First, there's the simpl that Americans are living longer in retirement, and that more. Next come internal corporate issues, including so



RETIRED STEELWORKERS in Ohio have given up on ever seeing benefits promised by their employers. Now they rally for government help instead

TRAP

health-care costs and long-term underfunding of pension promises. Perhaps most important, in the global economy, long-established U.S. companies are competing against younger rivals here and abroad that pay little or nothing toward their workers' retirement, giving the older companies a huge incentive to dump their plans. "The house isn't burning now, but we will have a crisis soon if some of these issues aren't fixed," says Steven A. Kandarian, who ended a two-year stint as the executive director of the PBGC in February. Kandarian is not optimistic about how that crisis might play out, either. "By that time it will be too late to save the system. Then you just play triage."

As industry after industry and company after company strive to limit—or eliminate—their so-called legacy costs, a historic shift is taking place. No one voted on it and Congress never debated the issue, but with little fanfare we have entered into a vast reorganization of our retirement system, from employer funded to employee and government funded, a sort of stealth nationalization of retirement. As the burden moves from companies to individuals—who have traditionally been notoriously poor planners—it becomes near certain that in the end, a bigger portion will fall on the shoulders of taxpayers. "Where the vacuum develops, the government is forced to step in," says Sylvester J. Schieber, a vice-president at benefit-consulting firm Watson Wyatt Worldwide. "If we think we can walk away from these obligations scot-free, that's just a dream."

What's WRONG With Retirement

Why U.S. companies are rapidly backing away from traditional pensions and health-care benefits for retirees:

COST

Retirees are living longer and costing more. The companies of the S&P 500 will have to contribute $14 billion to shore up their pension plans this year, UBS analysts estimate. Combined with annual retiree health-care costs in the tens of billions and rising at double-digit rates, many are concluding it has become too expensive to be generous with retirees.

COMPETITION

Newer and foreign competitors often don't bear the same retiree costs older companies do. Airlines like Southwest, JetBlue, and AirTran do not offer traditional pensions, while older airlines like Northwest and UAL have pension deficits per employee of close to $100,000, according to analyst Vaughn Cordle.

INSURANCE

Corporate pensions are backed by premiums paid to the Pension Benefit Guaranty Corp. With record plan failures and a multibillion-dollar PBGC deficit, there's pressure to up those contributions. The healthy are already subsidizing the weak: Steel companies pay less than 3% of PBGC premiums but account for 56% of claims.

ACCOUNTING

Accounting rulemakers are considering requiring companies mark their pension plans to market values to bring U.S. standards in line with international rules, a move that would greatly increase the plans' apparent volatility. When Britain made this shift, 26% of its companies closed their plans to new entrants.

VOLATILITY

Three years ago, pensions were generally self-funding and in the black, but some industries, including auto makers, were still weighted down by the sheer number of retirees. Then low interest rates and a down stock market plunged pensions from a $200 billion overage in 2000 to a $211 billion deficit in 2002.

EVIDENCE OF THE SHIFT is everywhere. Traditional pensions—so-called "defined-benefit" plans—and retiree health insurance were once all but universal at large companies. Today experts can think of no major company that has instituted guaranteed pensions in the past decade. None of the companies that have become household names in recent times have them: not Microsoft, not Wal-Mart Stores, not Southwest Airlines. In 1999, IBM, which has old-style benefits and contributed almost $4 billion to shore up its pension plans in 2002, did a study of its competitors and found 75% did not offer a pension plan and fewer still paid for retiree health care.

Instead, companies are much more likely to offer defined-contribution plans, such as 401(k)s, to which they contribute a set amount. In 1977, there were 14.6 million people with defined-contribution benefits; today there are an estimated 62.5 million. Part of their appeal has been that a more mobile workforce can take their bene with them as they hop from to job. But just as import they cost less for employ Donald E. Fuerst, a retirem actuary at Mercer Human source Consulting LLC, n that while even a well-matc 401(k) often costs no m than 3% of payroll, a typical fined-benefit plan can cost to 6% of payroll.

Despite the stampede to fined-contribution plans, th are still 44 million Americ covered by old-fashioned p sions that promise a set pay at retirement. All told, the owed more than $1 trillion 30,000 different compan Many of those employers h also promised tens of billion dollars more in health-care c erage for retirees. Even tra ferring a small part of the b den to individuals or government can have a p found impact on the corpor bottom line. The decision Congress to have Medicare c er the cost of prescript drugs, for example, will ligh corporate retiree health-c obligations by billions of c lars. Equipment maker Deer Co. estimates that the move shave $300 million to $4 million off its future health-c liabilities starting this year.

The U.S. Treasury, on other hand, pays and p dearly. That drug bene which takes effect in 2006 expected to cost the gove ment the equivalent of 1% of gross domestic product by 20 and other potentially big taxpayer costs are looming, too. mid-April, over the objections of the PBGC, Congress grante two-year reprieve from catch-up pension contributions for t of the most troubled industries: airlines and steel. Congr also lowered the interest rate all companies use to calcul long-term obligations, lowering pension liabilities. Wh these moves lighten the corporate burden, they increase chances taxpayers will have to step in. "The less funding quired, the more risk that's shifting to the government," s Peter R. Orszag, a pension expert and senior fellow in econo ic studies at the Brookings Institution. "The question is: H comfortable are we with the risk of failure?"

Company-sponsored health care, which generally covers tirees not yet eligible for Medicare and supplements w Medicare will pay, is likely to disappear even faster than co pany pensions. Subject to fewer federal regulations, those b efits are easier to rescind and companies are fast doing so. much harder to renege on pension promises. So instead, m profitable companies are simply freezing plans and denying

efits to new employees. Last fall, Aon Consulting found that of the 1,000 companies they surveyed had frozen their pen- plans in the previous two years, a dramatic increase from ier years. Another 60 companies said they were actively sidering following suit.

TRESS ON FRAGILE SYSTEM

The government bailout fund is $9.7 billion in the red, and Social Security and personal savings are hardly going to be enough

E COST OF HONORING PBGC'S COMMITMENTS COULD higher than anyone is expecting. The government bailout d has relied on having enough healthy companies to pony premiums to cover plans that fail. But in a scenario of rising n terminations, healthy companies with strong plans still in the PBGC system would be asked to pay more. For corporations already fretting that pensions have become a competitive liability and a turnoff to investors, this could be the tipping point. Faced with higher insurance costs, they could opt out, rapidly accelerating the system's decline as the remaining healthy participants become overwhelmed by the needy. In the end, the problem would land with Congress, which could be forced to undertake a savings-and-loan-type bailout. It's almost too painful to think about, and so no one does. But when the bill comes due, it will almost certainly be addressed to taxpayers.

Most worrisome is the record number of pension plans in danger of going under. According to the PBGC, as of September, 2003, there was at least $86 billion in pension obligations promised by companies deemed financially weak. That's up from $35 billion the year before. And it's on top of a record number of companies that managed to dump their troubled pension plans on the PBGC last year: 152. In 2003, a record 206,000 people became PBGC pensioners, including 95,000 from its biggest takeover ever, Bethlehem Steel Corp.

Even for healthy companies, pensions have become a serious

HE NEW RETIREMENT

KATHI COOPER

AGE 54

HOMETOWN Bethalto, Ill.

JOB STATUS Works in business controls doing internal reviews and assisting on internal audits.

MONTHLY PENSION Not yet retired. Is fighting in court changes IBM made to its pension plans.

HEALTH CARE IBM pays up to $7,500 per year for retiree health insurance, but no more.

Kathi Cooper graduated with honors from the accounting program at the University of Texas and has spent 25 years working in finance for IBM. Cooper says she needed that finance background to calculate how changes IBM was making to its pension plan in 1995 and 1999 would affect her. IBM, which faces younger rivals such as Microsoft and Dell that don't offer traditional pensions, was trying to cut costs. But Cooper, who had been planning on the benefits IBM had promised, didn't like what her calculations showed. So she sued. Last summer, she won the first round in the case against her employer, and IBM now calculates the case could cost it $6.5 billion if the plaintiffs' proposed remedy is accepted. That's a big number for a company with only $7.3 billion in cash on hand. Cooper argues that IBM's new plan, a so-called cash-balance plan that structures a pension more like a 401(k) account, discriminates against older workers. IBM says the plan is fair and gives workers who switch jobs more flexibility. Retirees at a half-dozen other companies, including Xerox, AT&T, CIGNA, and Georgia-Pacific have brought suits similar to Cooper's. "All I care is that every baby boomer in America realize what has happened to them," says Cooper.

CAUGHT SHORT

JAMES ROBERTS

AGE 56

HOMETOWN Harrisburg, Pa.

JOB STATUS Retired with a degenerative bone condition after 33 years as a crane operator for Bethlehem Steel's Stilton (Pa.) mill

MONTHLY PENSION $1,242.52

HEALTH CARE No company coverage, pays his own medical bills, including $200 a month in insurance and $450 a month in prescription drugs

James Roberts spent 33 years at Bethlehem Steel, 28 of them operating a massive ceiling-mounted crane in a mill turning c 20-inch steel. Sometimes he would work six days a week, 10 hours a day, often in shifts that started at 8 at night or 4:30 in morning. When he retired in November, 2000, he was only 53 but had begun to suffer from a degenerative bone disease as well as high blood pressure and cholesterol, all of which required monthly medications. But Roberts wasn't worried: He had a hea plan from Bethlehem and a pension of $1,887.75 a month. That all changed in 2002 when Bethlehem declared bankruptcy. The filing wiped out the retiree medical plans, and the pension was taken over by the PBGC, which cut Roberts' monthly payments by third. Some months Roberts goes without his most expensive medications, like Zocor, which he takes for high cholesterol at a monthly cost of $120 to $135. "With the pension cuts, I couldn't afford it," he says. Recently he took a part-time job working the lunch shift in a school cafeteria for $7.50 an hour.

drag. The companies of the Standard & Poor's 500-stock index, for example, continue to run an aggregate pension deficit of $149 billion, according to David Bianco, an accounting analyst at UBS. That's despite a strong stock market in 2003, which pushed up pension plan assets, and despite the billions companies contributed, including $18.5 billion from General Motors Corp. alone. If conditions don't change, Bianco figures the S&P 500 companies will end the year $192 billion in the hole.

WHAT TODAY MIGHT be seen as an isolated problem for a limited number of companies promises to bloom into big trouble for us all. By conventional math, the PBGC is already insolvent: As of September, 2003, it had $46.5 billion of liabilities and only $35 billion of assets, a deficit of $11.5 billion that had close to tripled in one year. The agency paid 2003 benefits of $2.5 billion, but only took in $1 billion of premium income from companies with defined-benefit plans. (The PBGC says the deficit had dropped to $9.7 billion as of March, but can't give further details.) The PBGC is not directly funded by the taxpayer, but it is backed by the U.S. government, which would likely bail it out in a crisis.

The fragility of that system only increases the stress on other sources of retirement income and insurance: Social rity, Medicare, and personal savings. Social Security h own $11.9 trillion deficit. And the still-recent history o sonal savings vehicles like 401(k)s shows that people g ally save too little, pay too much in fees, and fail to adeq ly diversify their risk. Olivia S. Mitchell, executive direc the Wharton School's Pension Research Council, is amon many who think one result is that we will all have to longer than we thought. "It used to be thought Social Se ty was the safe leg of the retirement stool, but that's no either," says Mitchell.

Demographic trends will only make matters worse. A cently as 1985 there were three U.S. workers for every re person. Now it's close to even. And we're still six years from 2010, when the first of the baby boomers will hit 65 only are more people retiring, but they're living longer they get there. Today 17% of the U.S. population is age 6 older. According to Census Dept. data, that figure will ri 26% by 2050, when college graduates entering the work today can finally begin to think about retiring. It's the plete reversal of the years after World War II, when comp

Adding Up the COSTS

Data: Labor Dept., Pension Benefit Guaranty Corp *AVERAGE YEARS SPENT IN RETIREMENT **ALL SINGLE-EMPLOYER PENSION LIAB ES IN 2002 DOLLARS, ASSUM G A 6 SCOU

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first began offering pension plans in great numbers. In those days the workforce was young and retirees were only a sliver of the population. It was easy to make promises.

The world has changed dramatically since then. In the '40s and '50s, if a company offered retirement benefits, its competitors probably did too. Pattern bargaining by unions held entire industries to the same standard. But companies that once could rely on geographic boundaries and market dominance to minimize the threat of upstarts and outsiders are now struggling to keep up in a global marketplace full of new competitors. Companies like IBM, Verizon Communications, and even General Motors today must contend with rivals who don't bear the cost of old-style benefits. For every lumbering US Airways there's an agile Southwest or Jet Blue Airways Corp., newer rivals with cheaper benefits. For every GM, there's a Toyota Motor Corp., with a leaner and younger U.S. workforce.

Nowhere are pension obligations a greater competitive millstone than in Detroit. The U.S. carmakers today have some of the biggest pension obligations and pool of retirees anywhere. By contrast, their Japanese competition only started U.S. manufacturing in the late 1980s, and have far lower costs. General Motors has 514,120 participants in its hourly-rate employee pension plan, all but 142,617 of whom are retired. Pension and health-care costs for those retirees added up to about $6.2 billion in 2003, or roughly $1,784 per vehicle according to Morgan Stanley. Compare that to Toyota's U.S. plan, which had only 9,557 participants, just two of whom were retired as of Toyota's latest Internal Revenue vice filing covering 2001. Toyota's pension cost is estimat something less than $200 per vehicle.

The impact on profits is dramatic. Excluding gains from i nance arm, GM earned $144 per vehicle in the U.S. in 2003. margins are now 0.5%, among the worst in the industry. without the burden of pension and retiree health-care costs auto makers' global margins would be 5.5%, according to gan Stanley. That's not great, but a lot closer to Asian carma like Honda Motor Corp., which earns 7.5% on its global sal

GOODBYE, RETIREE HEALTH CARE

Companies are racing to cut or drop retiree medical benefits to give a quick boost to their bottom lines

RETIREE HEALTH-CARE COVERAGE, WHICH IS EASIE eliminate than pensions, is disappearing even faster. Ur pensions, which are accrued and funded over time, ret health care is paid for out of current cash accounts, so any immediately bolster the bottom line. Estimates are tha many as half of the companies offering retiree health car years ago have now dropped the benefit entirely. Man

LAST OF A BREED

RICHARD DE LOS SANTOS

AGE 56

HOMETOWN Cleburne, Tex.

JOB STATUS Retired truck assembler at General Motors' plant in Arlington, Tex.

MONTHLY PENSION $2,090

HEALTH CARE Equal to when he was working full-time

As a retiree of General Motors, de los Santos is among a dwindling group still enjoying a traditional pension and generous health insurance from their employers. Entitled to retire in 1998 at the age of 51, after 3 years with the carmaker, de los Santos has launched a second career as a lawyer, defending Hispanics in mostly white Johnson County, about an hour southwest of Dallas. He put himself through college and law school while workin 8-hour shifts assembling trucks for GM. But if not for his $2,090-per-month pension, de los Santos says, he couldn't make it on a public defender's salary. Says the Matamoros, (Mexico)-born father of three grown children: "If I didn't hav my GM pension, I'd really have to work." GM's generous commitment to retiree's pensions and medical care is a throwback to the paternalistic era of the 1950s, before GM started competing against low-cost foreign auto makers like Toyota and Honda. These days, paying those lush retiree benefits saddles it with a $1,584 disadvantage per vehicle relative to its Japanese rivals.

ension
OES

For many old-line companies, pension deficits have become a staggering load...

COMPANY	2003 PENSION DEFICIT IN BILLIONS	DEFICIT AS A PERCENT OF THE COMPANY'S MARKET CAP
Delta Airlines	$5.7	379.1%
AES	1.3	79.2
Delphi	4.0	69.5
Ford Motor	11.7	69.1
Visteon	0.9	64.8
Allegheny Technologies	0.3	51.1
Hercules	0.4	38.3
Navistar International	1.0	35.7
Cummins	0.7	33.9
General Motors	8.6	28.8

...And shoring up pension funds is going to cost billions

COMPANY	2004 ESTIMATED DEFICIT REDUCTION CONTRIBUTION IN BILLIONS
Exxon Mobil	$1.8
Delta Airlines	1.1
Delphi	0.7
ConocoPhillips	0.5
Raytheon	0.4
Procter & Gamble	0.4
Motorola	0.4
Tyco International	0.4
Exelon	0.3
Abbott Laboratories	0.3

Data: UBS vestment Research

e that have not yet slammed the door are requiring their ner workers to bear more of the cost. Some 22% of the re- es who still get such benefits are now required to pay the rance premiums themselves, according to a study by He- Associates Inc. Some 20% of employers told Hewitt that might make retirees pay within the next three years. This hardest those who retire before 65 and are not yet eligible Medicare. But even older retirees suffer when they lose plemental health benefits like prescription coverage.

NOT JUST struggling companies, either. IBM, which is al- ly fighting with retirees in court over changes made to its sion plan in the 1990s, is now getting an earful from angry rees about health-care costs. In 1999, IBM capped how ch retiree health care it would pay per year at $7,500 of employee's annual medical-insurance costs. Although IBM rtainly in no financial distress—the company earned $7.6 on on $89 billion in sales last year—Big Blue says its med- costs have been rising faster than revenue. Last year the pany says it spent $335 million on retiree health care.

This year, for the first time, many IBM retirees are begin- g to hit the $7,500 limit. Sandy Anderson, who worked as anager at IBM's semiconductor business for 32 years, and ay is the acting president of a group of 2,000 retirees called efits Restoration Inc., saw his own insurance bill triple this r. He suspects that the company is trying to make the perk xpensive that retirees drop it, a cumulative savings calcu- d by the group at $100,000 per dropout.

But more than that, Anderson is angry that as a manager, encouraged him to talk to his staff about retirement efits as part of their overall compensation. The job market tight, and IBM's message was our salaries aren't the high- but we will take care of you when you stop working, he s. Now he feels the company is reneging. "I feel I've misled t of people, that I've lied to people," says Anderson. "It s not sit well with me at all." IBM says its opt-out levels are and that it often sees retirees return to the plan after opt- out for a period of time. The company also argues that it not changed its approach to retiree medical benefits for re than a decade and that the rising cost of health care is real issue.

Even with the reductions, Anderson and his generation of retirees are better off than many. In 2003 the giant computer maker said it would pay nothing toward health insurance for future hires when they retire.

THE PERFECT PENSION STORM

Three years of stock market declines plus record-low interest rates have left pension funds woefully underfunded

ONE REASON COMPANIES HAVE HIT THE ACCELERATOR ON dumping their benefits is because of sharp price increases. Retirement plans have become radically more expensive in the past two years alone. Due to smoothing mechanisms built into pension accounting, their investments are still suffering from the equity market declines of 2000, 2001, and 2002. That has put a big dent in the value of their stock holdings, generally 60% or more of their total assets. At the same time, interest rates, which are used to calculate the size of a company's liability, have remained stubbornly low, implying a bigger pension liability. Although the recent legislation eases the problem somewhat, it doesn't nearly close the gap between what these funds owe and what they have in assets.

Combined with the rise in retirees, those market conditions have led to two years of record underfunding in company-sponsored plans. A recent study by analysts at CreditSights Ltd. found that 85% of the defined-benefit plans in the S&P 500 don't have enough assets to cover their pension obligations. Together the underfunding equals 15% of their 2003 cash flow. As a result, companies will have to put billions of dollars of cash into these plans this year to help close the gap.

It's a drastic turnaround from the late 1990s when these plans had more than enough money. In 1999, the average S&P 500 pension was overfunded by $726 million, according to CreditSights. Four years later, at the end of 2003, it was $463 million underfunded, a swing of almost $1.2 billion. A steady rise in interest rates and a strong stock market could help to

solve that underfunding, but experts worry that the whipsaw effect of the past few years and the billions companies have been forced to contribute has heightened executive discomfort with the volatility of pensions. According to Credit Suisse First Boston analyst David Zion, the companies in the S&P 500 have contributed $88 billion to their pension plans over the past two years. They're likely to have to add another $31 billion over the next two years. Despite an $18.5 billion infusion into its pension plan in 2003, it will take years before General Motors, for example, has fully funded plans. "These things have a fairly long tail," says GM Chairman and CEO G. Richard Wagoner Jr.

Companies didn't make it any easier on themselves by contributing as little as possible to their pensions in the booming 1990s. As recently as 2001, half of the large pensions monitored by actuaries at Milliman USA were generating pension income, contributing an aggregate $12.5 billion boost to their parent companies' reported earnings. Companies with overfunded pension plans were often able to fund retiree health care with pension overage. Many companies contributed little or nothing to their pension plans as the bull market drove up assets more than enough. Former PBGC chief Kandarian notes that adjusting for inflation, in the early 1980s plan sponsors were putting $63 billion per year into their plans. By the last half of the 1990s that had dropped to $26 billion, and companies had become used to getting expensive benefits on the cheap.

WHEN THEY DID contribute, it was often not with cash but with stock, real estate, and other less liquid "alternative" investments. With pension promises basically free, companies were also offering pension increases in lieu of salary raises, increasing their obligations. From 1980 to 2000, the size of the promises made grew 2.3 times, Kandarian says.

Among those making the most extravagant retirement pledges were the steel mills, and it was in their plans that the industry's weakness was most dramatically realized. In a massive wave of bankruptcies, the steelmakers have shifted $7.5 billion of their obligations to the PBGC in the past 3 years.

But in that disaster some have found an opportunity to arbitrage the difference between the old retirement model and the new. International Steel Group Inc. has in the past two years grown into the largest steelmaker in the country by acquiring the mills of old steel companies, including Bethlehem Steel, LTV, and Acme Metals out of bankruptcy, once they've been freed of pension and health-care promises. These companies had been pummeled by cheaper international competition as well as lower-cost U.S. mini-mills, and as they shrank to cut costs, their retiree bases mushroomed to many times the si the active workforce. Faced with the possibility that they w lose all the remaining jobs left at these companies, the Ur Steelworkers union was eventually willing to compromise

RISK ARBITRAGE

A company free of its retiree promises can become a tougher competitor—though former workers suffer

FREE OF THOSE PENSION PROMISES, ISG CHAIRM Wilbur L. Ross Jr. enjoyed the big run-up in steel prices much cheaper cost base than many of his competitors. I predecessor companies shed $12 billion of legacy health-costs and another $9 billion of pension obligations. The c pany today claims to be competitive with both internati steelmakers and efficient U.S.-based mini-mills. ISG's defi contribution cost for employees was $45 million in 2003 very modest retiree health-care benefits cost $4.3 million contrast, Bethlehem Steel alone was paying out $500 milli year in pension benefits. Today, U.S. Steel Corp. has moved t ISG-style defined-contribution pension plan, but only for fu retirees. It still owes $8 billion to existing pensioners.

It's a bit of retiree-cost arbitrage that won't last forever. before it's over, Ross predicts other industries will follow harsh path to competitiveness. Those most at risk: textile m ers, airlines, tire and rubber companies, auto-parts suppl and, potentially, he says, the auto makers. "There is a huge funded liability that's building up because of the defined-be fit system," says Ross. "If nothing changes, the stone t [PBGC] have to roll up the hill will just get heavier."

Workers bear the brunt of it. Bill Luoma, head of the honing Valley Steelworkers Retirees Council, which co bankrupt LTV retirees among its members, says that with t health insurance gone, many have stopped visiting doctors er than for emergencies. For companies struggling to com in the global economy, carrying those burdens themselve like strapping on a 200-pound weight to run a 40-yard d But to shed them is to leave decades of workers devastated the end, someone will have to pay. The only question is wh

–With David Welch in De

Draining the PBGC

The five largest claims on the government-sponsored pension insurance pool:

COMPANY	TOTAL PLAN UNDERFUNDING (BILLIONS)	COST TO THE PBGC (BILLIONS)	YEAR OF TERMINATION	NUMBER OF PARTICIPANTS
Bethlehem Steel	$4.300	$3.650	2002	95,000
LTV Steel	2.200	1.849	2002	82,950
National Steel	1.500	1.216	2002	35,000
Pan American Airlines	0.914	0.841	1991	37,500
US Airways Pilots Plan	2.500	0.754	2003	7,100

Data: Pension Benefit Guaranty Corp.

BusinessWeek online For a Q&A with Brad Belt, executive directo the Pension Benefit Guaranty Corp., and a comparison of what a U.S. employer pays for retiree benefits vs. a European firm, go to www.businessweek.com/magazine/extra.htr

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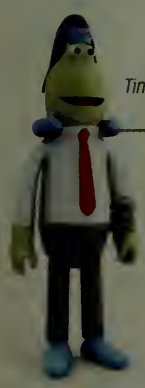

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Sizing Up the Street Watcher

How Inside Wall Street's picks in 2003 beat the major indexes

FOR INVESTORS, 2003 WAS the year when it was finally safe to come out of hiding. After three years of stuffing their unopened account statements in a drawer and ignoring phone calls from their brokers, investors saw their portfolios head north again.

And *BusinessWeek*'s Inside Wall Street column enjoyed a strong year as well, handily outpacing the gains in the major indexes. The 157 stock picks featured in the weekly column last year rose by an average of 26.4% in the six months after the column was published—more than double the average rise in the Dow Jones industrial average and the Standard & Poor's 500-stock index during the same period, and several points better than the NASDAQ Composite, Russell 2000, and Wilshire 5000 stock indexes.

BusinessWeek veteran Gene G. Marcial has written the Inside Wall Street column nearly every week since 1981. Last year Marcial got five weeks of vacation relief, from *BusinessWeek* colleagues David Henry and Mara Der Hovanesian, whose picks are also cluded in the performance returns.

Marcial talks with professional mo managers, analysts, and big investor find stocks on the cusp of breaking ou say, because of the launch of a potenti hot product or the likely approval c promising new drug. Or the pro may s ply feel that the company is dirt ch and ripe for a takeover. In fact, with 3 his picks, Marcial indicated that the co pany was a possible buyout candidat and three of them were purchased wit six months. In addition, Marcial rec mended four short sales in 2003 that sources felt were likely to decline (thou in a rising market, only one actually d Marcial's picks usually aren't intende be stocks to tuck away for the long te Rather, they're trading opportunities t often depend on short-term events.

To chart the performance of each st discussed in Inside Wall Street, we s with the closing price on Thursday, j hours before *BusinessWeek* is first av

Rebecca has

a passion for competitive swimming,
a 3.5 grade average,
a contagious giggle,
and Tourette Syndrome.

Rebecca is a terrific young lady who happens to have been born with Tourette Syndrome – a neurological disorder that's often misdiagnosed, misunderstood and a lot more common than you think. ((✕)) People with TS symptoms have "tics" – they sometimes make sudden, often strange, physical movements or vocal sounds that they *just can't help.* ((✕)) They're not psychologically impaired, less intelligent, obstinate, nor purposefully disruptive. Often, they're just as uncomfortable with their "tics" as you are. And contrary to what you may have heard, fully 85 to 90 percent are *not* prone to using inappropriate language. ((✕)) Research continues to explore the causes of Tourette Syndrome, and hopefully, the day will come soon when we can find better treatments and a cure. ((✕)) Until then, if you come across someone who has TS, please remember that, like Rebecca, that's not all she has.

Tourette Syndrome Association, Inc.

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IMPORTANT PUBLIC HEALTH INFORMATION REGARDING CLEFT LIP & PALATE

What Is Cleft Lip And Cleft Palate A cleft is a separation in a body structure. Clefts that occur in the oral-facial region often involve the lip, the roof of the mouth (hard palate) or the soft tiss in the back of the mouth (soft palate). Two major types of oral-facial clefts ar cleft lip/palate and isolated cleft palate Babies with cleft lip/palate have a cleft lip which usually is accompanied by cl palate. In isolated cleft palate, the cleft palate occurs by itself, without cleft lip other malformations. The lip or the lip and palate together fail to close in approximately 1 in every 1,000 babies born. Cleft palate occurs alone less often, appearing in approximately 1 in 2,000 babies.

What Causes Cleft Lip/Palate? The causes of cleft lip/palate are not well understood. Studies suggest that a nu ber of genes, as well as environmental factors, such as drugs (including sever different antiseizure drugs), infections, maternal illnesses, maternal smoking a alcohol use and, possibly, deficiency of the B vitamin folic acid may be involve

Can Oral-Facial Clefts Be Prevented? While little is known abou how to prevent oral-facial clefts, stud suggest that taking multivitamins conta ing folic acid before conception and during the first two months of pregnan may help prevent cleft lip/palate and isolated cleft palate. Other studies ha shown that fetuses with certain pre disposing genes may be at increased risk for isolated cleft palate if their mothers smoke.

Women who are planning pregnanc or who are pregnant should avoid alcohol, which also can cause a number of mental and physical birth defects. Because some types of medications (such as some drugs used to treat epilepsy) have been linked to increase risk of cleft lip/palate, women who tak medications for chronic illnesses shoul check with their doctors before they become pregnant. (They should not, ho ever, discontinue their medication witho discussion with their physician.). All pre nant women should use only medicatio prescribed by a physician who knows o the pregnancy, and get early and regul prenatal care, beginning with a pre-pre nancy visit. Families with a history of cleft lip/palate, isolated cleft palate, or any other condition of which clefting is part, may wish to discuss the chances recurrence with a genetic counselor.

Can Oral-Facial Clefts Be Repaire Surgery often is used to correct cleft lip/palate and isolated cleft palate. The timing and type of surgery depend upo a number of factors, including the prefe ence of the surgeon, the health of the baby and the nature of the cleft.

Other Sources Of Information On Cleft Lip And Palate. In addition to t valuable information we have tens of thousands of pages of information regarding cleft-related medical journal content, news articles and stories, impo tant cleft resources for patients, their families, and cleft medical professiona medical students and leading cleft orga izations around the world. For more inf mation on cleft lip and palate please vi the world's largest cleft website: **www.smiletrain.org** or call us at **1-877-Kid-Smile.**

The Smile Train has provided these materi for information purposes only; they do not constitute medical advice.

on our Internet site (www.business-k.com). Then we track the stock over next six months; we wait until now to Marcial's performance so the mns published in December can be ıded. We calculate one-day, one-th, three-month, and six-month re-s for the stock, and compute the av-e performance for each of those ods. Finally, we compare them with najor indexes. In every year since we ted compiling this Scorecard in 1998, cial's picks did better on average than S&P 500 after one month and better three months in six of those seven s. He also beat the S&P over a six-ıth period in four of the seven years.

ONE-DAY LIFT

CKS FEATURED IN the column usu-get a big one-day lift just from the ndant publicity, and Marcial certain-ad quite a number of stocks that ed right out of the gate last year. On first day of trading after the column's ase, the 157 stocks showed an aver-gain of 3.6%; 122 of them moved in direction that Marcial forecast. After month, the Class of 2003 was up 5, vs. the 1.7% returns for the stocks oth the S&P and Dow. And after three ıths, Inside Wall Street's recommen-ons had risen 17.7%—roughly 10 ıts better than the S&P, Dow, and shire, and six points better than the DAQ and Russell.

The biggest one-day winner was Sontra lical Corp., a small company that spe-zes in developing devices to deliver lication or monitor a patient's condi-through the skin. Sontra's shares had e-day pop of 94%, to $2.58, after Mar-noted in his Oct. 13 column that Sontra granted Bayer Corp. rights to market ıe of its technology. And ficient Inc. jumped 9% on Sept. 19 after Mar-reported that the tech ıpany, which helps big ware makers adapt their grams to work with their tomers' computer sys-ıs, would shortly expand relationship with IBM—ich it later did.

Some of the column's t ideas last year came n the resurgent technol-sector. One of Marcial's winners was Research Motion Ltd., mentioned the Nov. 3 column, ose shares surged 139% x months as demand for its popular Blackberry e-mail wireless devices continued to surge. (It's now up 213% through July 7.) Another winner was beleaguered telecom-supplier Nortel Networks Corp., which climbed 168.9% in the six months after it was cited in his Aug. 25 column. Carl Birkelbach, chief executive of Birkelbach Investment Securities Inc., told Marcial that despite Nortel's harrowing plunge from $86 to $2.84, the network-gear supplier had enough cash—$4 billion—to ride out the telecom storm. And indeed, Nortel's shares climbed to $7.88 over the next six months. But they've since slid back to $4.60 after Nortel fired its CEO and two top finance officers in late April and warned that accounting problems ran deeper than previously believed.

Another home-run pick was BIOLASE Technology Inc., which rose 171% in the six months after Marcial first mentioned it in his Feb. 3, 2003, column. Peter Cardillo, research director at Global Partners Securities Inc., was convinced that BIOLASE was a buy, given his belief that the maker of teeth-whitening equipment had developed other dental products—including lasers that let dentists perform root canals without anesthesia—that looked like winners. BIOLASE's stock surged from $5.30 to $15 by mid-July, although it did fall back to $10 in August after BIOLASE restated sales and earnings from 2000 to March 2003 at the urging of the Securities & Exchange Commission.

But the real winning play turned out not to be technology but perfume. Inter Parfums Inc., a New York company that sells mass-market perfumes, soared 182.8% in the six months after it was highlighted in the July 14 issue. Marcial noted that Inter Parfums had recently gained licensing rights to offer a line of Diane von Furstenberg scents and cosmetics. Michael James, a partner at Kuekenhof Capital Management LLC, said that given Inter Parfums' growing stable of designer names and its pristine balance sheet, the company was undervalued at $7.95 a share. James was on target: Inter Parfums was trading at $22.48 by January and still hovers above $17 now.

By contrast, the worst performer was

The Best Picks...

COMPANY/SYMBOL	GAIN
ONE DAY	
Sontra Medical SONT	94.0%
Perficient PRFT	60.9
Fountain Powerboat Ind. FPWR	25.6
ONE MONTH	
Perficient PRFT	86.8%
Sontra Medical SONT	69.9
R.F. Monolithics RFMI	68.2
THREE MONTHS	
Paxson Communs. PAX	166.5%
Biolase Techn. BLTI	97.8
Research In Motion RIMM	97.2
SIX MONTHS	
Inter Parfums IPAR	182.8%
Biolase Techn. BLTI	171.6
Nortel Networks NT	168.9

...And the Worst

COMPANY/SYMBOL	LOSS
ONE DAY	
Western Digital WDC	-6.2%
U.S. Dataworks UDW	-5.1
Acacia Research ACTG	-4.8
ONE MONTH	
Acacia Rsrch. CombiMatrix CBMX	-35.0%
Siga Technologies SIGA	-23.8
Cybersource CYBS	-22.3
THREE MONTHS	
U.S. Dataworks UDW	-41.6%
Concord Camera LENS	-40.2
Acacia Rsrch. CombiMatrix CBMX	-36.3
SIX MONTHS	
Sears Roebuck* S	-100.4%
Concord Camera LENS	-72.9
Biovail BVF	-64.4

*Short **Data:** Bloomberg Financial Markets, *BusinessWeek*

Taking on the Indexes

Inside Wall Street featured 157 stocks in 50 issues of the magazine last year. For each issue, the returns for the column and the market benchmarks were calculated for four time periods. The returns were averaged over all 50 issues. Here are the results:

	1 DAY	1 MO.	3 MOS.	6 MOS.
Inside Wall Street	3.6%	7.1%	17.7%	26.4%
Standard & Poor's 500	0.03	1.7	7.1	12.2
Dow Jones Industrials	0.1	1.7	6.7	11.5
NASDAQ Composite	-0.2	2.9	10.8	19.3
Wilshire 5000	0.1	2.0	7.9	13.8
Russell 2000	-0.1	2.9	11.9	21.9

Data: *BusinessWeek*, Standard & Poor's

Sears, Roebuck and Co. In his Feb. 24 column, Marcial noted that a hedge fund manager who did not wish to be identified was recommending shorting Sears' stock because of problems in its ailing credit-card business. But Sears stunned the shorts when it agreed to sell its credit-card business to Citigroup for $3 billion—a nice exit strategy that, when coupled with a stock buyback campaign, caused Sears' shares to double over the next six months, saddling the shorts with a 100.4% loss. (We assume that when a short position starts showing significant losses, an investor would receive and fully meet a margin call for more capital—which explains the lo more than 100%.)

The second-worst pick was Cor Camera Corp., which dropped n 73% in the six months after Marcial it in his Dec. 1 column. Bulls suc Michael Kim of Roth Capital Part LLC told Marcial that the maker of

The Inside Wall Street **Scorecard**

Here are the 157 stocks featured in Inside Wall Street in 2003. For each stock, we give the last closing price before the column became public, usually a Thursday. Then we compute the one-day, one-month, three-month, and six-month percentage returns. When any of those periods ends on a weekend, the prio closing price is used. When a company is taken over wit months, we calculate prices up to the merger's effective Thursday close is 11 days before the issue date.

COMPANY NAME / SYMBOL	CLOSING PRICE THURSDAY	PERCENT CHANGE 1 DAY	1 MO.	3 MO.	6 MO.	ISSUE DATE
Costco Wholesale COST	**28.25**	-2.6	-0.5	9.0	26.7	1/13/03
Cross Country Health. CCRN	**14.02**	-0.1	2.4	-15.6	-4.8	1/13/03
Herley Industries HRLY	**17.45**	1.8	-9.2	-3.2	0.1	1/13/03
Amer. Elec. Power[1] AEP	**30.00**	5.2	29.3	20.4	4.2	1/20/03
Harley-Davidson HDI	**48.66**	0.8	-16.2	-17.2	-20.9	1/20/03
ECC International[2] ECC	**4.28**	0.5	-0.5	-6.5	-0.9	1/20/03
Chubb CB	**56.02**	-0.7	-13.1	-11.9	7.8	1/27/03
Ocwen Financial OCN	**2.82**	3.5	2.8	18.8	62.4	1/27/03
Possis Medical POSS	**18.01**	1.4	-3.0	-3.6	-9.8	1/27/03
Sharper Image SHRP	**15.80**	0.4	-1.0	25.8	68.6	2/3/03s
BIOLASE Tech. BLTI	**5.36**	5.4	37.5	97.8	171.6	2/3/03
Acacia Rsrch. CombiMatrix CBMX	**3.00**	1.7	-35.0	-36.3	-3.3	2/3/03
May Dept. Stores MAY	**20.43**	0.3	-4.0	5.8	19.7	2/10/03
Kohl's KSS	**52.02**	0.7	-6.0	9.2	12.3	2/10/03
Gap GPS	**14.80**	-1.1	-11.9	12.4	20.3	2/10/03
Coach COH	**16.11**	-0.8	10.9	35.0	65.5	2/10/03
Tenet Healthcare THC	**17.45**	3.1	4.1	-15.0	-21.1	2/10/03
Amer. Elec. Power[1] AEP	**23.30**	-1.4	6.5	-13.2	-19.2	2/10/03
Omnicom Group OMC	**56.78**	-0.3	-13.7	13.5	25.4	2/17/03
Entergy ETR	**45.24**	-1.5	1.5	6.8	13.9	2/17/03
Vodafone Group VOD	**18.30**	0.5	-2.7	10.6	3.0	2/17/03
Viacom VIA	**36.14**	3.2	-0.1	24.0	17.6	2/24/03
Sears, Roebuck[1] S	**21.58**	-1.3	13.7	-29.1	-100.4	2/24/03
Asta Funding ASFI	**6.87**	0.7	9.1	45.3	87.9	2/24/03
Gallaher Group GLH	**37.86**	7.5	-2.3	2.6	-3.1	3/3/03
Gucci Group GUC	**79.20**	0.3	1.1	3.0	4.7	3/3/03
Pharma. Prod. Devel. PPDI	**28.37**	5.3	-12.5	-5.0	-12.6	3/3/03
Walt Disney DIS	**16.50**	3.4	6.5	14.4	25.6	3/10/03
Digene DIGE	**16.75**	-0.9	-6.6	43.0	109.3	3/10/03
Ribapharm[2] RNA	**4.57**	3.9	6.8	8.3	36.8	3/10/03
Paxson Communs. PAX	**2.30**	2.2	22.2	166.5	109.1	3/17/03
Metro-Goldwyn-Mayer MGM	**10.40**	2.4	3.3	16.5	43.1	3/17/03
Tootsie Roll Ind. TR	**26.61**	2.3	10.3	14.0	13.3	3/17/03
Kinross Gold KGC	**6.94**	-1.3	-18.6	-1.3	13.8	3/17/03
Matrix Service MTRX	**4.54**	9.0	23.9	75.1	131.3	3/17/03
Entertainment Prop. EPR	**25.75**	0.8	4.3	8.3	24.4	3/24/03
JetBlue Airways[3] JBLU	**16.17**	3.2	19.7	47.0	139.7	3/24/03
Diversified Security Sol. DVS	**7.05**	2.8	-0.7	-7.9	-2.1	3/24/03
EMCOR Group EME	**47.34**	3.2	2.3	6.7	-7.4	03/31/03

COMPANY NAME / SYMBOL	CLOSING PRICE THURSDAY	PERCENT CHANGE 1 DAY	1 MO.	3 MO.	6 MO
Drexler Technology DRXR	**13.24**	-2.3	8.8	29.8	21.2
Fountain Powerboat Ind. FPWR	**2.83**	25.6	44.0	27.3	24.9
LodgeNet Entertainment LNET	**9.44**	0.8	-0.3	11.2	55.5
Regis RGS	**24.95**	1.6	4.9	16.2	28.7
PCTEL PCTI	**9.28**	-2.5	5.0	22.0	14.2
Western Digital WDC	**9.96**	-6.2	-4.0	27.5	40.
Celeritek CLTK	**7.73**	-1.2	0.1	-1.8	2.3
Span-America Med. Sys. SPAN	**8.00**	4.4	12.3	8.3	16.0
CKE Restaurants CKR	**5.03**	4.4	6.4	36.2	31.4
21st Century Holding TCHC	**11.01**	3.8	16.9	55.3	67.2
Raindance Communs. RNDC	**2.10**	14.3	29.5	37.6	33.3
Bristol-Myers Squibb BMY	**22.53**	1.2	14.6	18.0	10.8
Advent Software ADVS	**12.72**	-0.9	10.5	32.2	49.1
First Health Group FHCC	**23.30**	0.4	7.3	16.1	5.8
Marvel Enterprises MVL	**10.39**	1.3	27.0	11.4	75.3
Tenaris TS	**23.80**	2.0	-3.4	10.1	14.9
Mellon Financial MEL	**26.01**	-1.0	0.8	14.5	13.5
Cendant CD	**14.45**	2.4	16.3	20.3	41.4
Staar Surgical STAA	**8.87**	8.6	25.5	24.1	11.6
Monster Worldwide MNST	**15.97**	4.9	24.5	63.4	59.5
Bunge BG	**27.40**	0.0	8.5	5.1	-2.4
Nautilus Group NLS	**13.40**	4.2	-7.5	-18.3	11.2
Intelli-Check IDN	**7.68**	2.1	-3.1	28.3	-6.4
Biogen[4] BGEN	**40.24**	1.7	-14.9	6.2	-24.3
Longs Drug Stores LDG	**14.24**	8.7	17.5	27.2	57.4
NetRatings NTRT	**8.40**	4.6	-0.6	17.6	17.4
Safeway SWY	**18.58**	1.1	7.7	30.5	11.1
Eclipsys ECLP	**10.13**	6.6	-1.4	41.9	-9.9
CenterPoint Energy CNP	**8.45**	7.0	3.0	-2.6	12.2
Veritas Software[5] VRTSE	**27.24**	1.8	4.9	25.9	39.6
Guitar Center GTRC	**23.45**	2.0	25.3	42.2	24.0
Saffink SFLK	**4.54**	-0.2	38.1	6.8	-11.2
Biovail BVF	**50.30**	-0.7	-7.8	-20.4	-64.4
KVH Industries KVHI	**21.65**	0.6	5.5	43.1	40.0
AstraZeneca AZN	**44.43**	0.7	-5.9	-3.2	5.2
Tommy Hilfiger TOM	**9.22**	-3.0	8.6	31.7	44.9
ProLogis PLD	**27.96**	-1.8	-2.6	4.1	12.2
SCO Group SCOX	**9.05**	23.9	18.1	96.1	77.0
H.J. Heinz HNZ	**33.50**	0.9	0.3	2.2	7.6

ble cameras was looking to ride the al boom with a new line of digital eras. And Gary Steiner of Awad & Asates felt that by producing in China, cord would be able to undercut betnown rivals such as Canon Inc. and n Corp. But Concord experienced lems in getting its models to market and trouble getting shelf space from retailers—saddling the company with heavy inventories of unsold cameras. "The digital business turned out to be more difficult to penetrate, and their first go-around didn't pan out," notes Steiner.

Concord's troubles, of course, serve as a reminder that diversification is important even in a rising market. But in a stockpicker's market like today's, Marcial's performance suggests that Inside Wall Street remains a good place to mine for ideas. ■

–By Dean Foust in Atlanta, with Robert J. Rosenberg, Michael J. Mandel, and Sarah B. Davis in New York

SYMBOL	CLOSING PRICE THURSDAY	PERCENT CHANGE 1 DAY	1 MO.	3 MO.	6 MO.	ISSUE DATE
	57.90	-0.2	3.7	4.2	11.5	6/30/03
ics RFMI	3.90	19.2	68.2	78.9	139.2	6/30/03
ial Svcs. PNC	48.60	0.0	2.3	-2.3	11.2	7/7/03
OLGC	4.09	7.6	21.0	37.2	50.4	7/7/03
WHI	10.99	1.7	13.2	8.7	70.1	7/7/03
ply TSCO	23.65	-0.3	17.8	45.4	66.5	7/14/03
Tech. PWAV	7.16	2.7	6.6	-4.9	11.2	7/14/03
ms IPAR	7.95	4.0	44.0	25.8	182.8	7/14/03
Pharmaceut. MLNM	14.51	1.5	-20.7	19.4	25.4	7/21/03
ATE	14.00	0.4	-12.7	27.1	-6.3	7/21/03
	26.84	0.0	7.5	26.5	45.1	7/21/03
Systems TFS	5.33	11.2	-2.5	26.2	2.7	7/28/03
ical DOW	30.60	2.1	10.5	15.0	34.3	7/28/03
Media TFSM	8.25	10.9	-8.5	-3.2	13.3	7/28/03
Pharm. HEPH	15.96	6.2	25.4	15.3	-5.1	8/4/03
	17.00	8.8	15.5	5.6	50.0	8/4/03
orp. ZION	55.50	3.0	1.6	5.3	10.0	8/4/03
m AMZN	41.64	-3.9	11.2	30.7	21.0	8/11/03
iver ACV	37.09	-0.8	2.6	14.0	12.7	8/11/03
ancshares CBSS	33.88	-1.4	1.4	11.5	16.3	8/11/03
lth Plans OHP	42.70	1.0	-15.1	-5.2	12.9	8/11/03
ritime GMR	12.13	1.2	0.0	4.3	73.1	8/11/03
tional Finl. FNF	25.87	2.2	3.4	12.4	44.0	8/25/03
works NT	2.93	-1.0	39.9	51.5	168.9	8/25/03
lealth Care[6] BBAL	3.42	5.8	4.7	13.5	-48.0	8/25/03
ms FLIR	26.62	0.7	4.4	27.3	48.2	9/1/03
PA	33.56	-1.0	0.6	3.4	15.2	9/1/03
Holdings ORH	20.77	0.1	4.6	4.9	26.8	9/1/03
mmuns. NXTL	18.06	7.0	7.0	40.3	46.7	9/8/03
vare MNS	8.06	2.4	-10.7	22.2	19.5	9/8/03
ldings LNCR	34.54	0.2	4.5	-13.7	-5.9	9/8/03
Health Svcs. UHS	50.65	1.0	-0.9	5.0	-5.7	9/15/03
rning TUTR	7.84	3.6	-1.1	39.2	65.4	9/15/03
SP	16.25	5.8	36.4	53.8	119.9	9/15/03
oadcasting Sys. SBSA	8.33	5.0	17.0	24.2	19.1	9/22/03
Intl. IGI	29.28	2.9	3.2	28.1	41.6	9/22/03
IWOV	12.20	4.9	13.1	3.6	-8.3	9/22/03
ics CTIC	11.30	7.1	-5.0	-29.0	-28.2	9/29/03
estaurants LNY	22.72	0.4	-2.5	8.0	30.7	9/29/03
PRFT	1.74	60.9	86.8	29.9	78.2	9/29/03

COMPANY NAME / SYMBOL	CLOSING PRICE THURSDAY	PERCENT CHANGE 1 DAY	1 MO.	3 MO.	6 MO.	ISSUE DATE
Yankee Candle YCC	25.68	-0.8	6.0	4.8	7.0	10/6/0
Dendreon DNDN	8.87	0.9	-5.7	-9.1	42.1	10/6/03
Acacia Research ACTG	6.00	-4.8	3.2	-8.3	8.3	10/6/03
W.R. Berkley BER	35.73	0.6	-4.0	-0.8	17.7	10/13/03
Liberty Media L	10.35	1.5	-2.5	15.7	7.5	10/13/03
Sontra Medical SONT	1.33	94.0	69.9	31.6	54.1	10/13/03
Boyd Gaming BYD	14.07	1.6	17.0	20.1	74.1	10/20/03
RADWARE RDWR	21.53	11.0	5.2	34.6	31.1	10/20/03
Immune Response IMNR	2.50	10.8	-6.8	-27.6	-33.6	10/20/03
Imax IMAX	8.60	3.7	-6.7	-6.5	-39.1	10/27/03
TJX Companies TJX	21.33	-0.5	4.3	10.6	18.7	10/27/03
Prime Hospitality PDQ	8.79	0.1	16.3	17.1	25.1	10/27/03
Research In Motion[7] RIMM	43.17	0.7	0.7	97.2	139.0	11/3/03
Spectrum Pharm. SPPI	7.39	4.2	-20.4	34.9	6.8	11/3/03
Strategic Diagnostics SDIX	4.35	4.6	1.4	10.3	-4.8	11/3/03
Black & Decker BDK	47.67	0.3	-2.7	7.5	21.4	11/10/03
Frisco Bay Industries[8] FBAY	8.05	10.3	11.8	87.6	89.4	11/10/03
SIGA Technologies SIGA	2.40	7.5	-23.8	-16.3	-37.5	11/10/03
Kroll KROL	23.49	0.0	5.0	6.2	28.4	11/17/03
Automatic Data Processing ADP	37.25	2.6	4.3	15.8	21.5	11/17/03
Harte-Hanks HHS	20.43	1.9	5.7	9.2	18.0	11/17/03
Patina Oil & Gas POG	22.63	0.1	5.3	6.7	16.7	11/24/03
CyberSource CYBS	5.74	-2.5	-22.3	-27.0	34.0	11/24/03
Entertainment Prop. Tr. EPR	33.28	-0.2	5.5	9.8	-1.7	11/24/03
General Mills GIS	44.27	0.4	1.7	1.9	3.2	12/1/03
Concord Camera LENS	10.30	1.8	-3.4	-40.2	-72.9	12/1/03
NTN Communications NTN	3.81	1.3	-3.9	-4.2	-28.1	12/1/03
Mattel MAT	20.14	0.5	-5.5	-6.0	-13.1	12/8/03
BIOLASE Technology BLTI	11.88	3.3	44.7	59.2	-0.1	12/8/03
Enpath Medical[9] NPTH	12.66	2.7	5.8	9.8	-5.3	12/8/03
Computer Prog. & Sys. CPSI	18.92	0.4	7.9	3.0	7.2	12/15/03
Bluephoenix Solutions BPHX	6.00	3.7	-1.7	-10.3	-13.8	12/15/03
Analogic ALOG	40.79	0.5	1.8	2.3	14.0	12/15/03
Middleby MIDD	35.95	4.5	10.7	13.7	56.4	12/22/03
Authentidate Holding ADAT	11.48	-1.1	19.8	23.6	8.1	12/22/03
US Dataworks UDW	3.53	-5.1	-9.3	-41.6	-57.2	12/22/03
Esperion Therapeutics[10] ESPR	22.57	0.6	53.5	55.1	55.1	12/29/03
Travelers Prop. Cas.[11] TAP/A	16.23	-0.9	11.5	6.7	10.2	12/29/03
TLC Vision TLCV	5.88	8.3	42.7	88.1	78.1	12/29/03

Cubic Corp., announcement date 8/21/03

Valeant Pharmaceuticals, ann. date 6/2/03.

7/23/04

m Biogen Idec Inc., ann. date 6/23/03; short

5. Ticker change effective 3/19/04 (from VRTS)
6. Delisted from NASDAQ 4/7/04
7. Split 2 for 1 ann. date 6/25/04
8. Acquired by The Stanley Works ann. date 1/20/04. 15.25/share
9. Formerly Medamicus, name change when acquired by Enpath on 2/2/04
10. Acquired by Pfizer, ann. date 12/21/03 at 35/share
11. Merger: stock deal with St. Paul Cos. to become St. Paul Travelers Cos. (STA) eff. date 4/1/04

† SHORT. Assumes all margin calls are met.

Lobbying For Laissez-Faire

Hedge funds are pouring money into campaign coffers to stop SEC regulation

HEDGE FUNDS HAVE ALways operated with few rules and scant oversight, their investment strategies shrouded in secrecy. But with the Securities & Exchange Commission poised to propose on July 14 that they must register with the agency, the funds have emerged from the shadows to fight the attempt to rein them in. Armed with PowerPoint presentations and piles of campaign cash, industry officials are beating a path to top policymakers to deliver their message: Hands off hedge funds.

Experts in aggressive trading, hedge funds are now learning to throw their weight around Washington, too. In the past six months, John G. Gaine, president of the Managed Funds Assn.—the trade group for the $800-billion industry—has met or spoken with SEC Chairman William H. Donaldson, Federal Reserve Chairman Alan Greenspan, Treasury Secretary John W. Snow, and House Financial Services Committee Chairman Michael G. Oxley (R-Ohio) to hammer home objections to the SEC plan. The new rule would let the SEC review hedge funds' investment strategies and check whether they are obeying the nation's securities laws. It also would raise the bar for people seeking to invest in most hedge funds: They would have to show a net worth of $1.5 million, up from $1 million.

Hedge-fund execs meanwhile have been busy writing checks to Washington pols. Employees of 17 funds that *BusinessWeek* identified as major donors have given $1.6 million to federal candidates and party committees for the 2004 elections, up from just $987,000 in 2002, according to the Center for Responsive Politics in Washington, which tracks campaign-finance data. With the industry boasting more than its share of liberals, Democrats pocketed 56% of the money. Some of the money may not be aimed at influencing the hedge-fund proposal.

UNDECIDED Shelby plans hearings on whether funds should be regulated

More than any other firm, New York-based Cerberus Capital Management, which ranks as the 12th-largest hedge-fund manager with some $9 billion in assets, has used campaign contributions and top-drawer lobbyists to gain entrée to lawmakers and top officials. Cerberus, for example, hired law firm Patton Boggs LLP, one of Washington's premier lobbying outfits. Patton Boggs then set up a June 10 m ing between Donaldson and former V President Dan Quayle, who is chair of Cerberus Global Investments, firm's private-equity arm.

BusinessWeek has learned that berus, with the help of Patton Boggs, tried to persuade the House Approp tions Committee to tie Donalds hands completely. In June, Cerb sought to have a restriction attache the SEC's fiscal 2005 budget that w prevent the commission from using dollars to enforce the new rules on he funds. But in mid-June, Oxley, whos nancial Services Committee oversees SEC, got wind of the maneuver and off a letter to the appropriations pane guing that it was not right to bypass on such an important matter. The res tion was never formally proposed, hedge funds still may try to block D aldson when the Senate acts on the c mission's budget. Cerberus officials Patton Boggs did not return repe phone calls asking for comment.

Opening Their Wallets

Hedge-fund managers have given at least $1.6 million to federal office seekers and party committees for this year's elections. The five top donors:

HEDGE FUND	TOTAL GIVEN*	KEY RECIPIENTS
Cerberus Capital	$280,250	Senate Banking Committ Chairman Richard C. She
Soros Fund	204,003	Democratic candidates
Perry Capital	198,250	Senator Hillary Clinton an other Democrats
Tudor Investments	170,000	Senator Charles Schume
Citadel Investment	133,550	Republican National Commit

*Including contributions to 527 groups Data: Center for Responsive

Cerberus has been busy courting senators as well. One of the political tion committees of Senate Banking C mittee Chairman Richard C. Shelby Ala.), for example, has received $133, from hedge funds and t law firms in the current e tion cycle—at least $79. of it from Cerberus offic and their spouses. She whose spokesman says hasn't decided whether not to support the SEC p posal, plans to hold a h ing on it on July 15. Sen Charles E. Schumer (D-N is another industry favo The 17 funds have given

> The new rule would let the SEC review funds' strategies

)00. Schumer, who represents a where many hedge funds operate who sits on the Banking Commit- "is studying the issue carefully," a spokesman for the senator.

ELLS LIKE TROUBLE'

GE-FUND OFFICIALS say regulation isguided. The funds are private in- nent pools for the rich, who under- l the risks and can comfortably ab- potential losses, they say. But what y worries hedge funds is that regis- on could be the first step on a slip- slope toward more intrusive rules. concern that Greenspan appears to . The Fed chairman told Congress February hearing that anything be- l registration could reduce the mar- iquidity that hedge funds generate eir voracious buying and selling of ks, bonds, and commodities.

ot all hedge-fund players are dig- in their heels. Already, some 40% of managers have voluntarily regis- l, mainly to attract pension-fund in- nents. Others think a "just say no" ce is a futile waste of political capi- ames S. Chanos, founder of Kynikos ciates Ltd., a New York investment that advises hedge funds, believes ndustry has grown too big, too fast cape the regulators' radar. Chanos, with his wife and Kynikos col- ues, has ponied up $136,000 in cam- n contributions, favors a limited reg- that would let the SEC keep a list of e funds without actually nosing nd inside them. Kynikos has hired hington lobbyist Andrew S. Lowen- vice-president of Van Scoyoc Asso- s, in hopes of jawboning the SEC such a compromise. Chanos did not rn phone calls.

ut Donaldson seems determined to g hedge funds to heel. The Wall Street rets over their dizzying growth and etimes unsavory behavior. Forty ls have been caught up in the mutu- nd trading scandal that began last tember, while the SEC has opened d investigations into another 41 e 2000. "You've got the acceleration oney going into hedge funds, more ple starting hedge funds, and every- striving to get the performance that ifies the high level of fees," says aldson. "That smells like trouble."

Iedge-fund managers are used to ing markets with their big bets. y're about to find out whether their ey talks as loudly in Washington. ■

–By Amy Borrus and Paula Dwyer in Washington

Fresh Seed In the Valley

After a long drought, small VC firms are popping up to fund startups

WHEN JOHN JAEGER set out to raise $3 million for his year-old tech start-up in January, he skipped right past Silicon Valley's top-tier venture-capital firms. "It might be difficult for somebody who has an $800 million or $900 million fund to take an active role" in such a small investment, Jaeger says. His company, telecommunications gear maker OnSite Systems, got the money from the $330 million Woodside Fund, which specializes in nurturing embryonic companies.

After a long drought in early-stage finance, VC firms are seeing opportunity in the industry's neglected first rung. At least 15 new firms have started raising funds in the past two years. They're joining longtime specialists such as Woodside and Labrador Ventures, which have recently raised new funds.

The rise in seed-stage VCs should soon translate into more deals as investors gain confidence that more startups can be nurtured all the way to an initial public offering. Such investments have shriveled over the past four years, falling from $3 billion in 2000 to just $378 million last year, according to a survey by PricewaterhouseCoopers, Thomson Venture Economics, and the National Venture Capital Assn.

These days, small VC players have an extra edge because newly minted companies are now worth much less than they were in the late '90s. So early-stage investments are smaller, taking many of the bigger VCs out of the game. "The math doesn't work," says Eric Janszen, managing director at Osborn Capital LLC. Indeed, a firm that must put $500 million to work in five years can't do too many $2 million deals without running its partners ragged chasing new companies and keeping tabs on all the investments.

So most of the big venture-capital firms will use smaller ones as pipelines to deliver them promising new companies to invest in. For example, IP3 Networks Inc. couldn't raise a dime from the Valley's top VCs. Founded in 2001, it was still too immature. Finally, in December, Garage Technology Ventures, a seed-stage VC, agreed to lead IP3's $500,000 first round of financing. The startup reached profitability in six months. Impressed, Sequoia Capital—the legendary backer of Cisco Systems and Google—led a subsequent $5 million round of financing in June.

That's how the system should work. So, as the industry recovers, expect those small VCs to get quite busy. ■

–By Justin Hibbard in New York

New York's Other Real Estate Mogul

Bruce Ratner, unlike high-profile rival Donald Trump, sees beyond Manhattan. Here's how he plans to revitalize Brookly

BRUCE C. RATNER, THE new owner of the New Jersey Nets basketball team, walks into the darkened control room of a Manhattan recording studio and shakes hands with two young producers. Ratner's day job is in property development; the tie he removed en route to this evening's recording session peeks out from the pocket of his rumpled suit coat. "I'm not cool, you know," he announces as the producers cue the sample Nets jingles they've worked up in a variety of styles. Ratner, 59, perches on the edge of a couch, smiling broadly and bobbing his head as hip-hop follows rock and reggae. "Wow!" he exclaims after each version. "That was really great!"

As fans of *The Apprentice* know, this is not how a big time New York developer is supposed to act. Where is the preening self-importance, the pursed-lip solemnity? Donald J. Trump would have fired both of these guys just for fun. The happily uncool, spotlight-averse Ratner will never promote his name into a brand, but he is emerging as one of the most daring and prolific developers Gotham has seen in years. "Bruce is very special," says architect Frank Gehry, who is working on two projects with Ratner's firm, Forest City Ratner Cos., an affiliate of Forest City Enterprises Inc. "His curiosity and intellectual capability make him an extraordinary client for someone like me."

In contrast with his Manhattan-fixated peers, Ratner ranges far and wide throughout the city, building whatever he thinks is in short supply: movie theaters, hotels, and big-box stores, as well as the prestige office towers and apartment blocks that so preoccupy the likes of Trump. His penchant for unproven, cutting-edge locations has left him with the occasional flesh wound. He has amassed a fortune estimated at several hundred million dollars just the same since most of his buildings have proven solid moneymakers, most notably the $1 billion MetroTech Center in Brooklyn.

Above all, Ratner is the developer who has brought downtown Brooklyn to the brink of radical transformation through two decades of contrarian investment. "He really is a visionary," says Rebecca Robertson, a former New York State official who had extensive dealings with Ratner during the redevelopment of Times Square in the 1990s. "The reason you haven't seen the same sort of thing happen in Queens that is happening in Brooklyn is because Queens doesn't have a R

NEW GRAY LADY Renzo Piano's design for the New York Times tower

Over the years, Ratner's visionar ity has been conspicuously absent w comes to matters aesthetic. Atlantic C a three-story shopping mall at Atlan Flatbush Avenues, has drawn esp heavy flak. "People say it's the uglies in the world," says Brooklyn Bo President Marty Markowitz. Ratne tles at the criticism—"it's certainly than any strip mall," he says—but h cedes the larger point. "The early did is not great architecture, I adm now I want to do good-looking build he says. "We haven't built a Taj Mah we're getting better and better."

"ANOTHER ROCKEFELLER CENT

LAST YEAR, GEHRY signed on to what promises to be Ratner's *pièce sistance*: a $2.5 billion, 17-tower co on the edge of downtown Brookly centerpiece of this colossal p known as Brooklyn Atlantic Yards, i a $435 million arena for the Nets now play at New Jersey's Meadow Unveiled in December, Gehry's pr nary design won rapturous re "Those who have been wond whether it will ever be possible to another Rockefeller Center can stop ing for the answer," declared *Th York Times*. "Here it is."

Brooklyn Atlantic Yards rema long way from certain. Forest City secure financing, acquire the 21-ac (which consists mainly of state-o rail yards), and guide its Garg through the usual maze of governm reviews. Ratner can count on the su of a bipartisan phalanx of officia cluding New York Governor Geo Pataki, New York City Mayor M

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mberg, and Markowitz, who cajoled er into bidding for the Nets in the place. However, the project does face ent opposition from neighborhood nizations that object to plans to use ic financing to cover part of the cost to condemn several residential build- on the site's fringes. More broadly, her has become a lightning rod for cs of Brooklyn's "Manhattanization." n July 25, Forest City Ratner will unveil its newest building, Atlantic Terminal, a $200 million office tower and shopping center built above Brooklyn's biggest commuter rail station. Atlantic Terminal is far swankier than the much-reviled Atlantic Center, which is located directly across the street and soon will be remodeled. Its opening is the culmination of Ratner's long campaign to persuade Target Corp. to locate a store in the heart of New York City.

Any day now, Ratner expects to break ground on one of Manhattan's most glamorous new office towers: a 52-story, $850 million headquarters for New York Times Co. Designed by celebrated Italian architect Renzo Piano, best known for the Pompidou Center in Paris, the building will be a slender tower of transparent glass sheathed in a webbing of white ceramic rods, with floors and stairs that appear to float. Paul Goldberger, *The New Yorker*'s architecture critic, was so dazzled

by the originality of Piano's design that he concluded that the new Times tower "bears almost no relationship to any tall building ever built in New York."

Piano won the Times commission in 2002, beating out four other world-class architects, including Gehry, who dropped out of the competition before it ended. A year later, Ratner asked Gehry if he could design a basketball arena as intimate as his acclaimed Walt Disney Concert Hall in Los Angeles. Gehry had never designed a full-fledged sports venue and wasn't all that eager to give it a try. But the architect was intrigued by Ratner's question and, equally important, by the developer himself. "If I like the person, I'll do the work," says Gehry, who also is designing a 40-story tower in Lower Manhattan for Ratner.

The developer may have greatly upgraded the aesthetics of his buildings, but he remains indifferent to his own appearance, despite the best efforts of Dr. Pamela R. Lipkin, his girlfriend of seven years. "Bruce is anti-fashion," says Lipkin, a plastic surgeon. "He has the worst clothes I've ever seen." Ratner, a divorced father of two, beams with pleasure when Lipkin's comments are read to him. He removes the navy blazer that is loosely draped over the back of his desk chair and holds it aloft for inspection. It is corrugated with creases. "I bought this a few days ago at Brooks Brothers," he says. "Look at it now."

Ratner, the son of Jewish immigrants from Poland, was born into a real estate family in Cleveland. Yet he made his way into property development circuitously, via Harvard University (where he concentrated on physics) and Columbia Law School. He was just 25 and a year out from Columbia when New York City appointed him its consumer advocate in 1971. Cracking down hard on fraud in the city's poorest neighborhoods, Ratner headed a 40-person staff that put scores of scam artists out of business and wrote laws that set a new standard for consumer protection throughout the country.

In 1978, Ratner realized "a life's dream come true" when Mayor Ed Koch appointed him commissioner of consumer affairs, the city's highest consumer post. "To me, Bruce was the next Ralph Nader," says Philip G. Schraff, a law professor who had taught Ratner at Columbia and preceded him as the city's consumer advocate. But in 1982, Ratner pulled a career U-turn, resigning to become a real estate syndicator. "I was making $52,000 a year and had two kids," he says. "I had a money issue. I had to leave."

Ratner worked in obscurity until 1984, when he took over a stalled urban re al project in downtown Brooklyn c MetroTech Center. The city had larde blighted 16-acre site with subsidies no developer wanted to take on ri such magnitude in a borough that h seen a new office tower in a quarter- tury. Ratner had all the right connec at City Hall but lacked money knowhow. He turned to Forest City terprises, a developer founded in C land in 1921 by four Ratner sibling cluding Harry, Bruce's fa (Charles A. Ratner, Forest C current CEO, is Bruce's cousin

Originally conceived as a 4.1 lion-square-foot project, M Tech today is 6.4 million sq feet and growing, with two r towers under construction. I fect, the Ratners created a t business district within New City by providing an alternati New Jersey for big companies were looking to move office w ers out of high-cost quarters in Mid and Lower Manhattan. In the e 1980s, "Brooklyn was alien territo big companies operating in Manhatt recalls former Mayor Koch.

SOCIAL RECLUSE

METROTECH WAS the template for ner in many ways, establishing him risk-taker capable of getting big, diff jobs done on time and on budget. C described as politically connected, Ra is well-versed in the ways of local gov ment and has hired many a former official. But he is also something of cial recluse who is as disinclined to shoulders with politicians as anyone "I think this mayor [Bloomberg] likes but I can't say we have a personal tionship," he says. "I can't rememb time when I picked up the phone called the mayor—any mayor."

Mayors come and go, but big real es projects go on forever. Ratner expec devote the next 10 years of his life to bu ing Atlantic Yards, which is just a blocks from MetroTech. Henry J. Ste well-traveled former city official who been a friend since the 1970s, pre rough times for the developer. "New is the negative city," Stern says. "Ev body has a built-in 'no' reflex, and t are a lot of timid politicians."

In the end, predict Stern and otl Ratner's combination of goofy charm relentless determination likely carry day. Who knows, he may even end up ing a mayor or two to dinner. ■

–By Anthony Bianco in Brooklyn,

FLATBUSH CHIC Atlantic Terminal design

BIO

Bruce C. Ratner

Not your typical publicity-hungry developer, Ratner took an offbeat route to the top:

BORN Jan. 23, 1945, Cleveland.

EDUCATION BA, Harvard College, 1967; LLB, Columbia University School of Law, 1970.

POSITION Founder and CEO of Forest City Ratner, an affiliate of Forest City Enterprises, a family-controlled company.

CAREER U-TURN Born into a real estate family, he got his start as a crusading public-interest lawyer. Appointed New York City's commissioner for consumer affairs at age 33. Left four years later to join his cousins in real estate.

LATEST CONTROVERSY Brooklyn Atlantic Yards, a $2.5 billion project, is meant to make Brooklyn a big-league city again. The Frank Gehry-designed colossus includes an NBA arena, 6.6 million square feet of offices and stores, and 4,500 high-rise apartments. Critics accuse Ratner of "Manhattanizing" Brooklyn.

NIGHT OWL Unwinds by reading, surfing the Net, and developing photos. Rarely sleeps before 2 a.m. Up at 6:45. "I'm fine with five hours sleep."

FAVORITE HOBBY Ocean fishing, but always alone and never from a boat. "I like to stand on the shore and feel the water around my legs."

FAMILY Divorced, two grown daughters.

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NOVATIONS

hot plates
d hearing aids

Miniature hot plates
eloped by Boston
oSystems are smaller
the width of a human hair
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bulb. Researchers are
rested in using the heaters
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building block in
otechnology. The
pany is also evaluating
hot plates for use in a gas
sor technology, still in
elopment, which would
itor air pollutants.

A new hearing aid uses
ficial intelligence to mimic
brain's ability to detect
speech while
filtering out
distracting
sounds. This
split-second
aural
discernment is
lost to many people
suffering hearing
impairment. There
are already digital
hearing aids with
microprocessors that
predict how a human
should hear the many
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con, a Danish hearing-aid
ker, says its Syncro device
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processor then makes
lions of calculations per
ond to determine
tantly the best speech-to-
se ratio.

–Sarah R. Shapiro

ON THE BALL

SMART SPORTSWEAR TAKES THE FIELD

A NEW, HIGH-TECH sports jersey could be useful for protecting players. The shirt, designed by David Evans, a student at Britain's Northumbria University, is fitted with lightweight sensors to monitor the heart and with silicon-gel strips to measure fluid loss. The readings are sent by radio transmitter to a laptop on the bench, alerting the coach if a player is seriously fatigued or dehydrated. In addition, the shirt can be rigged to monitor body temperature continuously. The sensors are permanently attached to the shirt and durable enough to be machine-washed. Evans says he is hoping to recruit an athletic-gear manufacturer to mass-produce the shirt.

–Adeline Bonnet and Jasper Perkins

FUELS

FILL 'ER UP—WITH STRAW AND YEAST

IN THE FAIRY TALE, Rumpelstiltskin could spin straw into gold. Now, a Canadian biotech company is using genetically modified yeast to improve the transformation of straw into ethanol.

Yeast has long been used to break down glucose in corn and ferment it into ethyl alcohol, which is then added to gasoline and sold as a motor fuel. But straw, corn stalks, and other crop leftovers contain xylose as well as glucose—and natural yeast can break down only one sugar at a time. Nancy Ho, a molecular biologist at the Purdue University Laboratory of Renewable Resources Engineering, found that by adding three genes to yeast, the organism can convert both sugars simultaneously into ethanol. The new process boosts ethanol yields by 30% to 40%. Purdue has licensed the yeast to Iogen in Ottawa.

–Michael Arndt

THIN EDGE

A PROTEIN THAT KEEPS MICE IN SLIM CITY

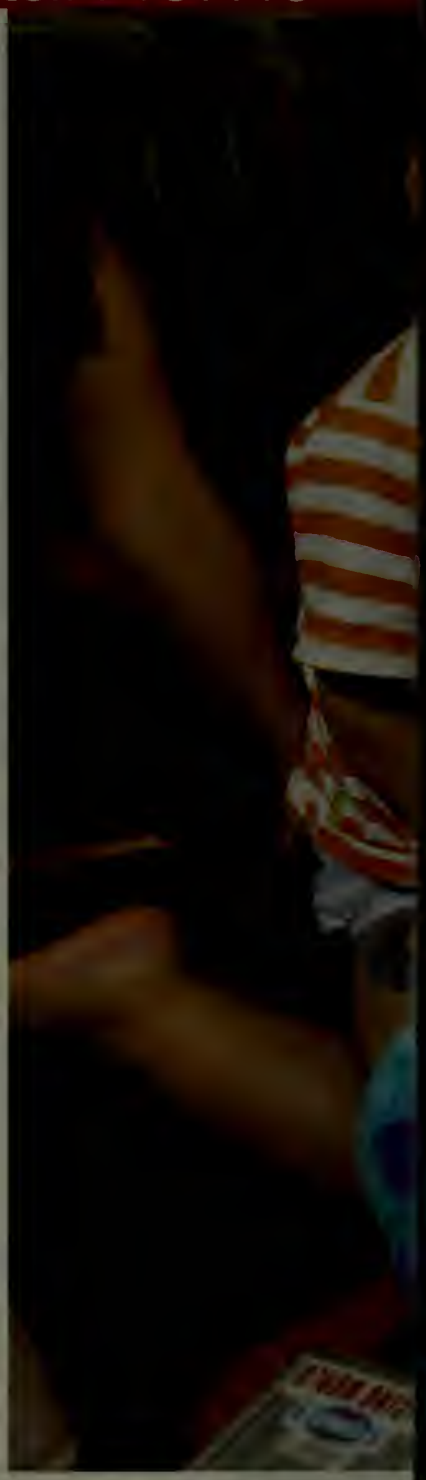
SOME SVELTE MICE IN Michigan may hold the key to treating obesity in people. These genetically engineered mice can eat as much high-fat food as they want—and still be only half as hefty as ordinary mice, even those on a low-fat diet.

Researchers at the University of Michigan Medical School in Ann Arbor had discovered four years ago that a protein called Wnt10b, one of a family of proteins regulating embryo development, can repress fat-cell growth in tissue cultures. To determine its effect in animals, a team led by Dr. Ormond A. MacDougald developed mice with 50 times the amount of Wnt10b found in normal mice. The engineered animals had only half the usual fat cells, and they could eat as much as they wanted of a high-fat diet without gaining weight.

There were side effects: The skinny mice were much more susceptible to cold, and their skin was twice as thick as normal. At the same time, Wnt10b shows therapeutic promise in preventing bone loss. MacDougald says drug companies are targeting that potential. "If such a drug could also block the formation of new fat cells, that could be very appealing," he says.

Ready To Buy A Home Robot?

C-3PO they're not—yet—but more smart devices are available than you might think. **BY CLIFF EDWARDS**



FOR A ONE-MONTH-OLD, THE LATEST addition to the Lee family runs circles around the word *precocious*. She sings, dances, and even teaches English to 4-year-old Lee Da-bin and 7-year-old Da-yea. Those feats and other special talents are something only a robot like herself can claim. When Mom, Choi Ji-Hoon, is out, she can use a wireless link to peek in on things through the robot's video camera eyes and send video messages to the kids through an embedded monitor. "When the kids play with the robot, I don't need to lift a finger," she says. Indeed, the hardest part might be figuring out a name for the $3,600 invention of Korean robot maker Yujin Robotics. The iRobi model heralds the age of home robots. Early versions are nothing like what you would imagine. Forget the picture-perfect duplicates seen in the film *The Stepford Wives* or the evil two-legged creatures doing battle with actor Will Smith in *I, Robot*. In Japan, Korea, Europe, and the U.S.—not to mention distant reaches of the solar system—we're relying on robotic systems for repetitive c such as vacuuming or mowing the guarding our homes, and driving cars. In the future, we're betting, r will watch over the elderly, tend t sick, and help us stay in touch friends and family over vast dista With one-third of the planet expect be 65 or older by 2050, the potential ket for robotic companions is huge.

Can you run to the store and buy bot? Chances are, you already hav the definitions of many engineers, TiVo digital video recorder anc

LSO IN THIS SECTION:
90 A chat with iRobot's Roomba man
92 Footnotes: Give your cell phone a boost
94 Barker: Domino's IPO isn't as tasty as it smells

SEOUL
Lee Da-yea, 7, and Da-bin, 4, play with their $3,600 iRobi robot

vave oven are robotic simply because contain sensors, microprocessors, rudimentary artificial intelligence allow them to do repeated tasks with-human intervention. Toys are also a ed of robotics: For $200, you can buy bot-invention kit called LEGO Mind-ms. Your trusty BlackBerry e-mail sole fetches messages with the help of i-autonomous robot software pro-ns, known as bots.

tep into the garage and you are in a ro-e world. And we're not talking about te-controlled door openers. In Japan, Toyota Motor sells its Prius sedan with an Intelligent Parking Assist System, part of a $2,600 options package that allows the car to parallel-park itself. Both Toyota and Honda Motor will soon extend worldwide their lane-keeping options that use cameras and sensors to alert you when your car veers off course or make adjustments to keep you in a lane.

Granted, these aren't walking, talking robots such as C-3PO or R2-D2 from the movie *Star Wars*. Scientists call them mobile robots. They include robotic toys that start at about $100 and encompass appliances such as iRobot's $200 Roomba vacuum and its lookalikes, which are useful for light cleaning and are entertaining to watch. "We're excited about things that have moving parts, that seem to behave of their own accord," says researcher Illah R. Nourbakhsh of Carnegie Mellon University's Robotics Institute.

Early robots are undergoing continual refinement. Sony's pet "dog," Aibo, has gone through several incarnations in its five years on the market. Over the next decade, such gizmos are expected to get smarter, with skills that rival some human

ones. By 2010, semiconductor researcher Future Horizons in Kent, England, predicts that there will be 55.5 million robots in the world—many of them domestic robots—in a market worth $59.3 billion. "The electronics industry is on the cusp of a robotics wave, a period in which applications are aimed at human labor-saving and extending human skills," says a Future Horizons report.

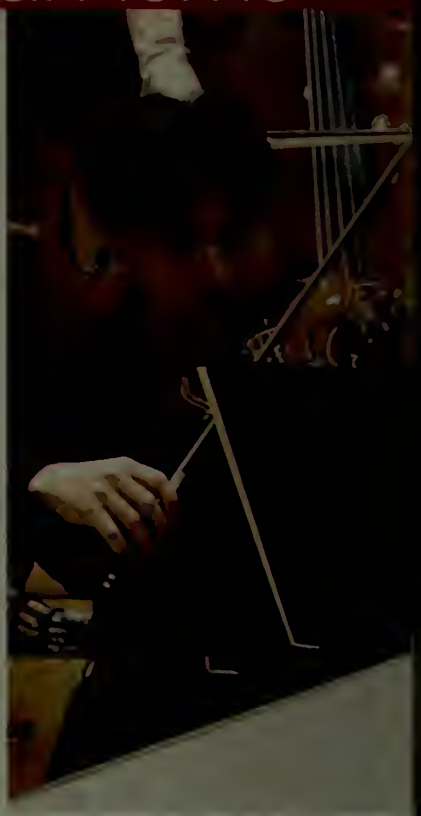
For a glimpse into the future, *BusinessWeek* checked out some of the most intriguing robotic developments—things your digital home could grow to love. Many are still laboratory fantasies costing millions of dollars to make. But researchers say costs will come down rapidly over the next decade or so as engineers perfect and mass-market the devices. A "smart" robot such as C-3PO that researchers hope to pioneer as personal assistants to the world's rapidly aging population could cost $20,000 or $30,000. Here's what we have found in the world's digital homes—and what's on the launchpad:

» ENTERTAINMENT ROBOTS

THE STRAINS OF *When You Wish Upon A Star* flow naturally from Toyota's 4-foot-tall, 77-pound, unnamed robot. Its synthetic lips alter their position on the trumpet mouthpiece as air from artificial lungs is forced through. The robot's gleaming white body sways to the rhythm of the song as metal-and-plastic-composite hands press the trumpet stops. Song over, the robot bows and waves to the audience. Clearly, this is one robot that knows how to toot its own horn.

Some of today's most popular entertainment robots are little more than toys, but they're attracting plenty of attention. With 67 preprogrammed moves controlled by a remote, Wow Wee's $100 Robosapiens have been hot sellers at Fry's Electronics and other U.S. stores. At the other end of the price spectrum is Sony's $1,800 robot canine, Aibo ERS-7, which can fetch, respond to its owner's voice, take photos, and find its recharger when its batteries run low. Researchers such as Toshiyo Tamura, a biomedical engineering professor at Chiba University, finds that pet robots can provide great comfort to the elderly.

Japan is the mecca of robotic pets as well as the first humanoid robots. Companies there are investing hundreds of millions of dollars to preserve their lead. In 2000, Honda unveiled ASIMO, one of the first remote-controlled, two-legged, walking robots. Last year, Sony introduced QRIO, which can jog, dance, and handle many complex movements previously too difficult for robots. In one demo, QRIO even conducted a small orchestra. Computer giant NEC has created a robot with humanlike expressions that speak 3,000 phrases. None of these tures is for sale yet.



» APPLIANCE ROBOTS

WITH A NOISE THAT sounds to *nessWeek* reviewer Ariane Sains R2-D2, Trilobite turns itself on an

Your Robot Retinue

Large numbers of robots may soon be in our homes—but will we recognize them? Simply put, a robot is any electromechanical device with intelligence (the silicon variety), sensing, some autonomy, and the ability to carry out instructions until told to stop. Over time, some of these gizmos may laugh and cry like humans. Here's what's available today and what's in the pipeline:

ENTERTAINMENT ROBOTS

Toys are the advance guard in home robotics, from Wow Wee's inexpensive Robosapien up to Sony's "canine," Aibo. Relatively simple software allows such products to move around and communicate, but they still can't tell the difference between a person and a couch.

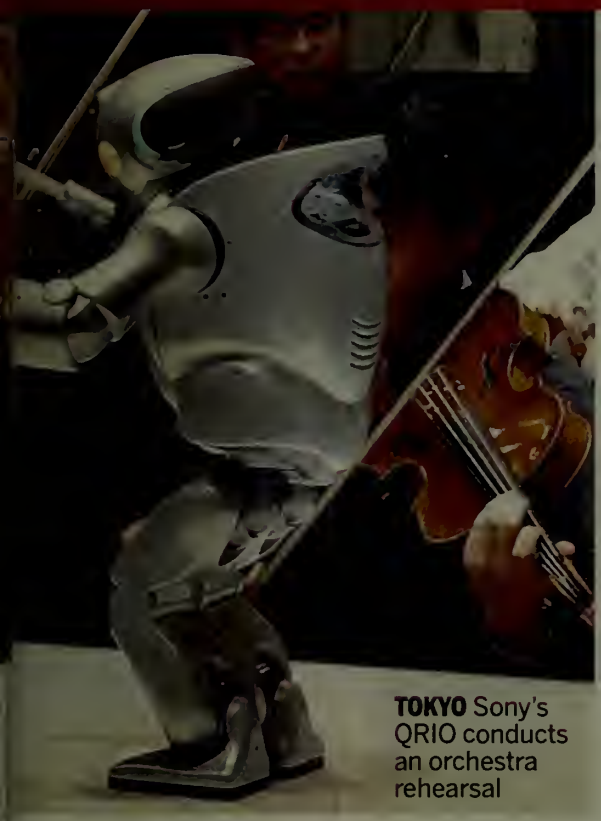
COST: Robosapiens start at $100, Aibos at about $1,800 ▼

APPLIANCE ROBOTS

These household products perforr some useful functions, but people mostly buy them because they're iRobot's Roomba vacuum and Electrolux's Automower, respectiv vacuum and mow, but they can sti tripped up by corners, tight space objects in their path. Watch for tra cans that roll themselves to the c and edgers that get into spots you vacuum or Automower miss.

COST: Roombas start at $200, Automowers at $2,400 ▲

(TOP) JIJI PRESS/AFP/GETTY IMAGES; (AIBO ERS-7) YOSHIKAZU TSUNO/AFP/GETTY IMAGES; (QRIO) ITSUO INOUYE/AP/WIDE WORLD



TOKYO Sony's QRIO conducts an orchestra rehearsal

its trek around the living room. robot is a 14-inch-wide vacuum s shaped like a thick frisbee. An sound monitor helps it avoid ing into furniture, and an infrared eeps it from falling down stairs. But several occasions as Sains moves nd to test its avoidance skills, the robot goes for her toes.

Things go downhill from there. The $2,300 robot from Sweden's Electrolux gets tangled in electric cords and tries to drag several rugs around the room. Instead of sucking up dry leaves on a carpet, it mulches them, creating a big mess. Says Sains: "It's an expensive gimmick that doesn't save much time."

Electrolux and iRobot, maker of Roomba, argue that perfect cleaning isn't the point. The new vacuums are for fun, too. Researchers say these early appliance robots use decades-old software, which helps keep the price down but also makes them the dumbest of smart devices. Still, iRobot has sold hundreds of thousands of Roombas starting at $200. And the robots are sure to become even more affordable and ubiquitous because of their labor-saving abilities, says Steve Richards, president of robot maker Acroname in Boulder, Colo.

One big area for appliance robots is home security, featuring devices such as Aibo and Yujin's iRobi robot. Consumers use their PCs or cell phones to connect to the bots on the Internet and direct them to prowl rooms, sending back images as they move along. Unlike larger robots in science fiction, they pose little risk of accidental injury or damage to furniture (page 90).

Help for the elderly is likely to be a huge global market

>> IMMOBOTS (NONMOVING ROBOTS)

IT'S DAWN, AND when the alarm clock goes off, it sends a signal to the coffee maker to brew two cups. The coffee maker then tells your medicine cabinet to check the pollen count on the Net and, if needed, recommends allergy pills on its display panel. The medicine cabinet also checks the weather and sends a message to your wardrobe closet that it's going to be rainy and cold. By the time you get to the closet, it's suggesting in an English butler's voice that you wear your black suit and overcoat and take an umbrella.

Meet the immobots. These bossy cabinets and wardrobes—still just gleams in the eyes of researchers at Accenture Tech-

MOBOTS

brain than brawn, these critters y move. They're mostly software rams, such as the ones in your TiVo scan program databases decide what to record. Teams of obots will work together in digital es, so when your alarm clock rings, nals your coffee maker to start ing and alerts your cine cabinet to check the weather pollen count. Then the cine cabinet ▼ might tell your wardrobe to suggest lighter garments on a muggy day—it's up to the bot.

COST: These programs are embedded in other products

ASSISTIVE ROBOTS

Rapidly aging populations will rely on robots for surveillance, to fetch drinks or medicines, and for help walking. Japan's Fujitsu and South Korea's Yujin already sell home-surveillance robots. And some GM cars already come with seats that slide out to help their riders get in.

Companies are developing ◀ "exoskeletons" —steel-and-polymer suits you slip on to drastically increase your physical strength.

COST: GM's Sit-N-Lift robotic seat is a $4,600 option on the Chevy Venture and other models. Yujin's guard robot costs $3,600

ANDROIDS

Sony's QRIO, ▶ Fujitsu's HOAP2, and Honda's ASIMO are early steps toward creatures that look, act, and reason like humans. If androids are ever perfected, they could be companions, even soulmates. Hum a few bars of a Cole Porter tune, and they'll pluck your fave version from a song collection on your server or from the Net. They could even let you win a game of chess now and then or joke with you about a bad TV show. Today humanoids can amuse you—at great expense. Someday they will also protect, counsel, and console.

COST: FUJITSU'S HOAP2, $53,000

TAKING SHAPE Sculptor Hanson with a robot head he's working on

nology Labs and Philips Electronics—are the least robotlike of the home robots. Rudimentary versions are steadily coming to market. You've heard about Web refrigerators—ones that could someday order groceries when they sense you're running low or check the Internet for recipes based on what you have inside. Samsung Group, LG Electronics, and others are starting to sell these along with Internet washing machines, stoves, and microwave ovens engineered so that they could communicate with manufacturers when key parts start to wear out. Such appliances tend to be pricey, costing $7,000 and more in some cases. But manufacturers are determined to bring prices down.

More brain than brawn, immobots rely on embedded software and, increasingly, Internet connections to talk to each other and to you. They are the hidden agents that let your PC zap music files to your stereo system. Such programs are proliferating fast. The global market for embedded software, estimated at $99 billion, is expected to reach $138.4 billion in 2007—about 9.25% annual growth, according to researcher Gartner.

The next big thing in this category is an explosion of wireless sensors, starting with radio-frequency identification (RFID) tags. Used by retailers to track inventory, they could also monitor the movement of pill bottles in smart medicine cabinets—warning if you reach for the wrong pill. Even such simple things as sensor pressure pads placed in jams could combine with wireles nology to alert a caregiver when a with dementia moves outside a d area in the home.

A Robotics **Gold Mine**

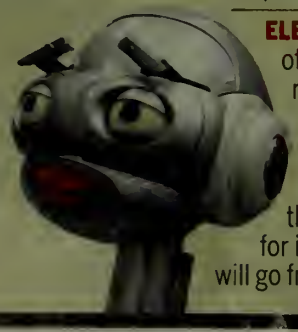
Components and software used in home robots and systems to support them could rake in billions

EMBEDDED SOFTWARE Gartner estimates that the market for robots' software brains should grow 9.25% annually, to $138.4 billion, by 2007.

SERVERS AND STORAGE To keep the digital home running smoothly and manage vast entertainment archives, robots will interact with trillions of bytes of information that are stored locally. Bernstein Research predicts that the home-server and storage market will grow from $129 million today to $1.1 billion by 2007.

ELECTRONIC COMPONENTS Chips are the lifeblood of home robotics. European semiconductor researcher Future Horizons predicts that the market will soar from $398 million in 2003 to nearly $24 billion in 2010.

IMAGE SENSORS Mobile robots will have to find their way around homes—which means a windfall for image-sensor makers. iSuppli thinks this market will go from 253 million units in '03 to 733 million by '08.



SNEAK PREVIEW Carnegie Mellon's "Pearl"

»ASSISTIVE MOBILE BOTS

DANA LE NEVER worries about p a name with a face. The Accentur researcher counts on Personal Awa Assistant to do it for her—using a s recognition engine, two small phones, a tiny camera, and a scrolli dio buffer attached to a Microsoft PC PDA. Le knows that when sh "it's nice to meet you" to someon party, that person's name, along low-resolution photo, will plug in sophistic address Upon that again, could w into the phone, was the met at the last We day?" promptly an answe

> Your closet, knowing the weather, could suggest an umbrella

Assistive robots already come i ous sizes and shapes. While the Jap may be leaders in robotic systems fo Detroit is starting to see their mark tential. General Motors sells an a called the Sit-N-Lift power seat tha a robotic arm to fold out and pick u erly or less mobile passengers. Sit- is a $4,600 option on the Chevy Ve Pontiac Montana, and Oldsmobil houette. "While robots carrying might seem a bit of a stretch, ther be some useful applications," says Sanger, an auto analyst at ING Secu in Tokyo.

Jumping ahead, robotic assistant take the shape of dogs, flies, and eve Some, such as PLUTO, a Great Dan beast being developed for the milit Cincinnati-based Yobotics, will be autonomous. It might run at 15 halfway up a mountain, drop off plans to a platoon commander, the night-vision sensors to peer into ca enemy encampments. Another might help with your child's sc project, planting itself in your bac taking time-lapse photos of all the that get caught in a spider's web.

Other creations, such as Le's Pe Awareness Assistant, aim to remak into a character from *The Six Millio*

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lar Man or *The Bionic Woman*. An elderly person might put on a lightweight steel-and-polymer exoskeleton suit that provides extra strength for a daily walk. Gartner predicts that 40% of adults will use some form of wearable computing within the next decade.

>> HUMANOIDS

ALSO KNOWN AS ANDROIDS and general-purpose robots, these are what children and sci-fi fans most dream about. Scientists and even artists such as Dallas sculptor David Hanson, want to give androids a human face. But they're the hardest robots to create because we expect them to have human emotions and reactions, says researcher Cynthia Breazeal of Massachusetts Institute of Technology's Media Laboratory.

Robots aren't yet street-smart. They perform ably tasks that follow set rules, such as going from point A to point B. But when the playbook is taken away, as in most cases involving human interaction, all but entertainment and toy robots come up short. Scientists are struggling to create software that allows robots to adapt to unexpected obstacles. "
you think it's easy for you to do, n
the time it's very difficult for rob
do," says Takeo Kanade, direc
Carnegie's Robotics Institute. Tha
robotics today is more science
fiction. That means that Rosie the
or whatever you might nan
is going to feel right at home ir
digital home. ■

–With Ian Rowley in
Andrew Petty in Seoul, Arian
in Stockholm, Adam Aston in N
and Andy Reinhardt i

A Chat with Roomba Man

'You don't want a big honkin' machine rumbling through your home'

HOME BOT
HOME CE
Angle wi
some iR
products

THE SURPRISE SUCCESS OF iRobot's Roomba vacuum cleaner marked the arrival of mobile robotic appliances. It also added a consumer hit to iRobot's line of high-tech military and one-off models. Yet the company's 36-year-old CEO and co-founder, Colin Angle, is cautious about the future of more advanced humanoid robots. Here are edited excerpts of his chat with *BusinessWeek* Industries Editor Adam Aston:

When can we expect to see multipurpose domestic robots, doing a variety of tasks in the home?

Rosie the Robot of *The Jetsons* won't be there for us anytime soon. If Moore's Law [for semiconductor evolution] keeps going, though, we'll get there. But it will be closer to 20 years, not a decade.

Today's household robots may be pets or appliances, like the Roomba. How will they look in the future?

The robots want to stay as small as they can be. That way, from a liability standpoint, they do less damage, pose less risk of injury, consume less energy, move most easily, and so on. You don't want a big honkin' machine rumbling through your home.

What kind of infrastructure needs to come into being for robots to work in the home? Wireless networking? Power stations?

The communications and power are all pretty basic. We have the technology now to do what we need. The bigger challenge [for cleaning 'bots] is what to do with the waste: How do you get rid of the dust or the dirty water? Where will clean water for mopping come from? Even for humans, home maintenance has a lot to do with supplying and applying cleaning agents and then removing the resulting waste. For a robot, this suggests homes will need ports where the 'bots can return to empty their waste, recharge, and refill supplies.

Will robots interact among themselves?

Absolutely. Relatively special-purpose machines will need to communicat
one another. One robot will push a
so another can come clean an area.
uum cleaner comes, then it signa
mopping robot to come behind it.
sentry robot says, "There's a spill,
summons the cleanup robot.

The kitchen and the playroom seem to be driving household-robot developments. What about elder car

Robotics will play a big role in addre
that need. [Otherwise] what will
with people who don't want to g
nursing homes? Over the next 10
you'll see attempts to provide autor
live-in care services. If a robot can e
a person to live alone even a year o
there will be a big demand. ■

A sumptuous quiche
for brunch at
magazine editor's loft.

A splendid yet easy
eggs benedict dinner for
au pair and children tonight.

A scrumptious créme brulee
for tonight's benefit dinner.

sudden realization that
forgot to buy eggs.)

Life's

EDITED BY TODDI GUTNER

INVESTING

ETFs of All Flavors

THE UNIVERSE OF EXCHANGE-TRADED FUNDS continues to expand. On July 2, **Barclays Global Investors,** which has more than 80 offerings, introduced nine ETFs based on Morningstar indexes. The new ETFs divide stocks into value, growth, and core investment styles, and identify whether they invest in small-cap, mid-cap, or large-cap stocks. In the fall, San Francisco-based Barclays is expected to roll out the first China ETF, which will track the FTSE/Xinhua China 25 index. Barclays also plans to launch the first gold ETF and a socially responsible ETF.

That's not all. **PowerShares Capital Management,** a Wheaton (Ill.) firm with two ETFs, is set to add 25, including PowerShares Dynamic Large Cap Growth Portfolio, which focuses on 50 blue chip stocks. ETFs, which trade like stocks and have $167 billion in assets, have been gaining momentum since the mutual-fund scandal broke last fall. But issuance has been limited to index-linked products. What's holding up actively managed ETFs, says Lee Kranefuss, who oversees ETFs at Barclays, is that "nobody wants to disclose their portfolio on a daily basis." *–Lauren Young*

HAIR CARE

FOR DECADES WOMEN HAVE poured beer over their heads to help repair damaged hair. Now some salons offer Kahlúa conditioning treatments, made by mixing the coffee-flavored liqueur with conditioner, half and half, and ingredients such as jojoba. After 20 minutes under a heat lamp, the concoction causes hair cuticles to close, making tresses soft and shiny, says Kim Vo, co-owner of B2V salon in West Hollywood. The treatment costs $30 at B2V and New York's Maximus, among others. But there's no reason you can't try it at home. *–Arlene Weintraub*

GADGETS

WHEN YOUR CELL PHONE NEEDS A JOLT

HOW CAN YOU avoid getting caught with a cellular phone that dies in the middle of an important conversation? **Cellboost,** a disposable battery charger, plugs into your phone to give it an extra jolt good for an hour or so of talk time, or 60 hours on standby. It looks like a Zippo lighter and comes in different models that mate with the charger ports of most cell phones. You'll pay $5 to $ electronics stores, double if you nee buy it in an airport shop.

TRAVEL

CHECKING IN WITH A CLICK

MOST AIRLINES ALLOW e-ticketed passengers to print boarding passe after checking in for flights using th Web. Some limit online check-in to domestic flights or frequent fliers. T table shows how far in advance airl let you check in—and how close to time you can wait before being bun

AIRLINE (WEBSITE)	EARLIEST ONLINE CHECK-IN (HOURS)	LAT (MI
American aa.com	30	6
Continental continental.com	30	6
Delta delta.com	24	3
JetBlue jetblue.com	24	9
Northwest nwa.com	36	6
Southwest southwest.com	24*	6
United united.com	24	6
USAirways usair.com**	30	9

*Starts at 12:01 a.m. local time day of departure
Shuttle passengers may check in no earlier than 24 hours before departure **Data: Airline Web sites,Busine

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Life's Good

BY ROBERT BARKER

Domino's IPO: Not as Tasty as It Smell

Hungry for an IPO? With Google in the wings and first-day pops such as those lately at software makers Blackboard (up 43%) and Salesforce.com (56%), it's only natural to feel greed's pang. Now, Wall Street wants you to save an appetite for the initial public offering coming soon from a familiar name: Domino's Pizza.

With nearly 7,500 outlets worldwide, Domino's, based in Ann Arbor, Mich., is so well-known that it has many earmarks of a can't-miss proposition. In a $385 million deal led by J.P. Morgan Chase and Citigroup, the No. 1 pizza deliverer is set to sell 37% of its equity to the public at an estimated $16 a share. Current owners, mostly funds run by Bain Capital, plan to keep $219 million of the net proceeds. Domino's aims to use most of the $137 million it nets to pay off some debt. The fresh cash can only aid Domino's in its war with Papa John's International and Yum! Brands' Pizza Hut chain. Less certain is whether Domino's can satisfy investors' hunger for a hot stock.

AHEAD OF THE IPO, Domino's is keeping mum. Yet students of entrepreneurship, franchising, and *Roe v. Wade* all will recall its story. Founded in 1960 by Thomas Monaghan, who grew up in foster homes and a Catholic orphanage, Domino's eventually brought him wealth enough to buy many worldly baubles—cars, houses, even the Detroit Tigers—plus a controversial role in the anti-abortion crusade. By 1998, he decided to focus more intently on that and a host of other Roman Catholic causes via his Ave Maria Foundation (which is set to sell 3 million shares in the IPO). So Monaghan quit as CEO and sold 93% of Domino's to Bain. In the next five years, Bain expanded Domino's locations by one-fifth. S that time rose 13%, to $1.3 billion last year. Pretax incom 2%, to $62 million.

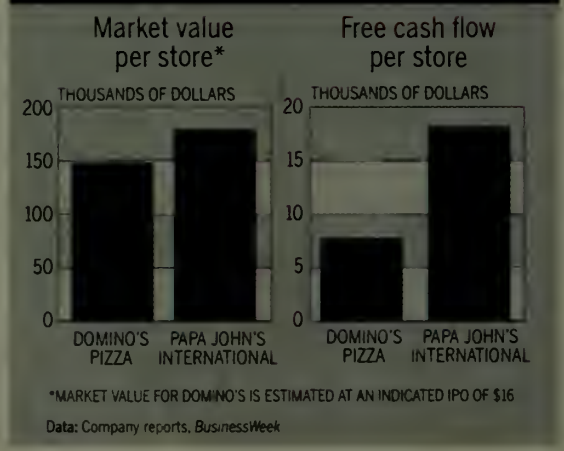
Look again at those numbers. For all of Bain's work— archrival Papa John's concedes that Domino's is sharper under Bain—making pizzas remains one tough biz. The day, I stopped by a Domino's and saw I could take home 14-inch pepperoni pizza for $6.50. The price of a 12-inch DiGiorno's pepperoni pie from the supermarket freezer? $6.47. David Flanery, Papa John's CFO, told me the indu hooked on discounting. "We have got to break that cycle dependence" on promotions, he said. Higher costs are squeezing margins, too. Cheese spiked to more than $2 pound this spring, from last year's average of $1.31. It ha fallen to $1.44, but the episode r anyone who makes pizza for a li

Amid this harsh climate, wha happened to the value of Papa J shares? It had a total enterprise (stock market value plus net del $1.2 billion in December, 1998, Bain bought Domino's. Today, P John's enterprise value is $600 million. At an IPO price of $16 a share, Domino's would comma enterprise value of $2 billion. T twice the $1 billion value Bain p on Domino's back in 1998. Papa John's value has been halved, w Domino's, in the IPO, could dou

True, Domino's is both bigge helpful in spreading TV advertis costs over more stores—and enj more growth abroad. But what's worth? Imagine you could buy a the equity in Papa John's or Domino's. The cash return on P John's figures to be much highe (charts). In the latest four quart ended in March, Papa John's generated free cash flow of $53 million, a 10.2% return on its cu market value. Domino's generat $58 million, a 5.2% return. May that relationship will change on Why anyone would bet that it w can't imagine. ■

E-mail: rb@businesswe

PIZZA WAR



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BY DAVID HENRY

ONE MAN'S UPBEAT VIEW OF BEATEN-DOWN PIER 1 IMPORTS.

CONSOL ENERGY'S COAL COULD SOON FETCH RED-HOT PRICES

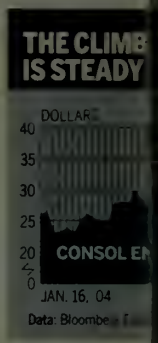
THRIFTY REGIONAL JETS FROM EMBRAER ARE STREAKING AHI

A Second Act for Pier 1?

SHARES OF PIER 1 IMPORTS (PIR) are in the doghouse. The stock is off 32% in the past 16 weeks, and most Wall Street analysts covering the retailer are down on it. For five quarters, Pier 1's earnings have come in short of the forecasts its managers offered up front, says A.G. Edwards. Now annual earnings per share will be down for a second year, at $1.21, when the fiscal year ends in February, 2005, according to analysts tracked by Reuters Estimates. But Robert Olstein, manager of the Olstein Financial Alert Fund, says that with the stock so far down, it is cheap enough to buy. He owns 1.6 million shares. "Pessimism and bad news create the low price we want," says Olstein. He's upbeat because the 42-year-old company is reworking the mix of merchandise, overhauling the advertising, and retraining sales staff. Same-store sales will start to recover, possibly as soon as the end of summer, he says, and the stock, now at 17, will jump to 25—as Wall Street sees Pier 1's underlying earning power of $1.50 a share. There's a precedent for Olstein's view. When Pier 1 was in a similar fix in 1999, this column quoted another lonely bull and saw the stock climb 50% in six months.

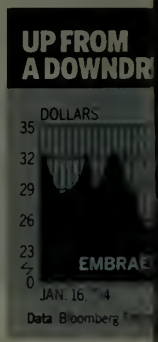
Consol May Get Fat In a World Hungry for Coal

CONSOL ENERGY (CNX) is up 50% since January. To suggest there's still room to climb seems like fantasy. But you had better believe it, says Dan Rice, portfolio manager at State Street Research & Management. Consol, rich in the Appalachian coal burned in electrical plants, trades at 37 and includes a gas business worth about $15 a share. "It is an $80 stock," insists Rice. He already has a big gain in the stock—owning nearly 9 million shares acquired over the years at an average price of 15. Yet he's holding on for more. The reason: A persistent shortage of coal should push prices sharply higher, as was the case with natural gas, which has tripled since 2001. Few coal mines are opening, because of troubles with environmental regulation and lawsuits. At the same time, demand for electricity is growing beyond the capacity of gas-powered plants. Rice predicts Consol's average selling price will climb from this year's $28.70 a ton by at least $4 a ton next year and again in 2006, producing annual free cash flow from coal of more than $6 a share, four times this year's level. Right now the stock market is valuing Consol's potential cash flow from coal at only $22 a share. Jonathan Wolff, an analyst at Wachovia Securities, rates the stock a buy, citing Consol's operating leverage and strong cash flow growth.



Why Embraer's Planes Fill the Airlines' Bill

TRADITIONALLY, WHEN investors saw the demar commercial aircraft about to take off, they plowe money into Boeing. But old habits are changing favor of a competitor from Brazil: Embraer—Empresa Brasileira de Aeronáutica (ERJ). David Williams, a po manager at U.S. Trust, is high on the stock because re air travel is growing around the world. Embraer is ahe competitors Boeing and Bombardier in offering fuel-efficient, midsize jets (70 to 110 seats), he notes. The p are popular with low-cost U.S. carriers, including JetB Airways (JBLU) and in Europe, with Finnair and Alitalia. Embraer sells some 95% of its aircraft in U.S. dollars, so the stock doesn't have the currency risks that normally come with Brazilian investments. Total debt-to-capital is a reassuring 38%. Free cash flow will grow at a compounded annual rate of 24% through 2008, forecasts Merrill Lynch. Williams says the stock is worth at least 36. Merrill's target is 38 by December. The shares are trading at 28 today, just 11 times 2005 earnings estimated by analysts at $2.68 a share, according to Thomson First Call. That's a bargain at ju Boeing's p-e of 21, says Williams. ■



Gene Marcial is away for severa

BusinessWeek online Gene Marcial's Inside Wall Street is postec businessweek.com/ today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays. See Gene on Fridays at 1:20 p EST on CNNfn's *The Money Gang*.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street n firms hold positions in the stocks under discussion. Similarly, they have no inv banking or other financial relationships with them.

Personal Business Figures of the Week

OCKS

S&P 500

IMENTARY

ak jobs-growth number on 2 set the tone for the rest of eek, sending stocks lower onds higher on weak me. Adding to unease was a e of warnings from such tech panies as PeopleSoft and xant that sales will be on w end of projections. ever, the news on July 7 of a ome rise in mortgage cations lifted the markets.

loomberg Financial Markets, Reuters

U.S. MARKETS	JULY 7	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1118.3	-2.0	0.6	11.3
Dow Jones Industrials	10,240.3	-1.9	-2.0	11.1
NASDAQ Composite	1966.1	-4.0	-1.9	14.3
S&P MidCap 400	592.2	-2.5	2.8	19.7
S&P SmallCap 600	287.8	-2.9	6.4	25.9
Russell 3000	634.0	-2.1	0.6	12.4
SECTORS				
BusinessWeek 50*	647.2	-1.1	4.0	9.0
BW Info Tech 100**	338.3	-3.4	-3.5	5.0
S&P/BARRA Growth	554.2	-2.3	-0.3	8.2
S&P/BARRA Value	559.9	-1.6	1.5	14.5
S&P Energy	254.4	1.4	13.5	31.0
S&P Financials	379.3	-1.3	-0.1	10.6
S&P REIT	122.5	2.7	7.9	18.1
S&P Transportation	202.3	-2.2	0.2	12.5
S&P Utilities	120.4	-0.1	1.7	7.6
GSTI Internet	156.5	-6.6	8.2	16.9
PSE Technology	698.3	-5.1	0.1	17.9

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	JULY 7	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1187.6	0.0	0.7	24.7
London (FT-SE 100)	4358.4	-2.4	-2.6	7.0
Paris (CAC 40)	3660.4	-1.9	2.9	15.0
Frankfurt (DAX)	3930.6	-3.0	-0.9	17.9
Tokyo (NIKKEI 225)	11,384.9	-4.0	6.6	16.2
Hong Kong (Hang Seng)	12,320.3	0.3	-2.0	24.5
Toronto (S&P/TSX Composite)	8481.9	-0.7	3.2	20.0
Mexico City (IPC)	10,042.0	-2.3	14.2	39.2

FUNDAMENTALS	JULY 6	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.66%	1.63%	1.61%
S&P 500 P/E Ratio (Trailing 12 mos.)	20.8	21.1	32.7
S&P 500 P/E Ratio (Next 12 mos.)*	16.4	17.0	17.5
First Call Earnings Surprise*	7.78%	7.98%	6.54%

*First Call Corp.

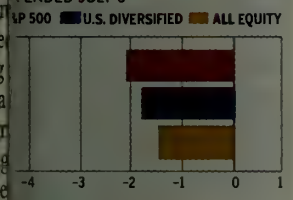
TECHNICAL INDICATORS	JULY 6	WEEK AGO	READING
S&P 500 200-day average	1099.9	1097.8	Positive
Stocks above 200-day average	63.0%	67.0%	Neutral
Options: Put/call ratio	0.81	0.69	Positive
Insiders: Vickers NYSE Sell/buy ratio	3.07	3.12	Negative

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Constr. & Engineering	13.5	Internet Software	85.3
Steel	12.7	Oil & Gas Refining	81.4
Oil & Gas Exploration	9.8	Steel	72.0
Divsfd. Metals & Mining	9.6	Divsfd. Metals & Mining	69.2
Oil & Gas Drilling	9.5	Fertilizers & Ag. Chems.	65.4

WORST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Health-Care Distributors	-20.3	Health-Care Distributors	-21.5
Advertising	-12.3	Broadcasting	-16.0
Application Software	-10.9	Airlines	-14.5
Semiconductors	-9.8	Biotechnology	-11.1
Electric Mfg. Svcs.	-9.6	Insurance Brokers	-10.6

TUAL FUNDS

EEK TOTAL RETURN
K ENDED JULY 6



VEEK TOTAL RETURN
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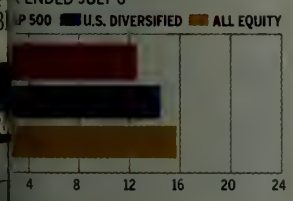

tandard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Natural Resources	5.7	Natural Resources	35.5
Real Estate	3.9	Japan	31.2
Utilities	1.9	Latin America	30.5
Small-cap Value	0.5	Europe	29.3
LAGGARDS		**LAGGARDS**	
Technology	-6.2	Technology	8.6
Health	-3.3	Domestic Hybrid	8.6
Large-cap Growth	-3.0	Large-cap Growth	8.7
Mid-cap Growth	-2.8	Health	10.3

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
State St. Rsch. Gl. Rs. A	9.7	Fidelity Japan Small Co.	67.9
Fidelity Sel. Energy Serv.	9.6	U.S. Glbl. Invs. G. Rscs.	67.5
Fidelity Sel. Nat. Gas	9.2	U.S. Gl. Invs. Prc. Mnls.	59.8
Rydex Energy Svcs. Inv.	9.0	iShares MSCI Austria Ix.	59.4
LAGGARDS		**LAGGARDS**	
ProFds. Smicdr. Ultsr. Inv.	-17.0	Frontier Equity	-30.8
iShares Gold. Sachs Smcr.	-12.1	Ameritor Investment	-28.2
Rydex Electronics Inv.	-12.0	ProFunds UltSh. OTC Inv.	-28.0
Fidelity Select Electronics	-11.7	Rydex Dynam. Vent. 100	-27.8

INTEREST RATES

KEY RATES	JULY 7	WEEK AGO	YEAR AGO
Money Market Funds	0.77%	0.71%	0.68%
90-Day Treasury Bills	1.30	1.29	0.88
2-Year Treasury Notes	2.54	2.70	1.33
10-Year Treasury Notes	4.48	4.58	3.68
30-Year Treasury Bonds	5.22	5.29	4.70
30-Year Fixed Mortgage†	5.99	6.22	5.55

†BanxQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.88%	4.84%
Taxable Equivalent	5.54	6.91
Insured Revenue Bonds	4.07	5.09
Taxable Equivalent	5.81	7.27

THE WEEK AHEAD

RNATIONAL TRADE *Tuesday, 13, 8:30 a.m. EDT* » The oreign trade deficit is cted to have declined to $47.8 n after hitting a record gap of 3 billion in April. That's based e median forecast of omists surveyed by Action omics LLC.

IL SALES *Wednesday, July 3:30 a.m. EDT* » Retail growth probably fell by 0.3% e after a big 1.2% jump in May. Minus autos, sales very likely posted a 0.4% increase, after a 0.7% gain from May.

PRODUCER PRICE INDEX *Thursday, July 15, 8:30 a.m. EDT* » Producer prices in June are forecast to have moved up 0.2% after a 0.8% surge in May. Excluding food and energy, core prices very likely nudged up 0.1% after increasing 0.3% in May.

INDUSTRIAL PRODUCTION *Thursday, July 15, 9:15 a.m. EDT* » June industrial production probably held steady after a robust 1.1% rise in May. The average operating rate very likely slipped to 77.7%, from 77.8% for May.

CONSUMER PRICE INDEX *Friday, July 16, 8:30 a.m. EDT* » June consumer prices for goods and services most likely rose 0.2% after a 0.6% rise in May. Excluding food and energy components, June prices probably moved up 0.2% for a second straight month.

The *BusinessWeek* production index declined to 218.8 for the week ended June 26, but remained 11.3% higher than the previous year level. Before calculation of the four-week moving average, the index held at 220.7.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.htm

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Sarbanes-Oxley: Time to Step Up

MENTION "Sarbanes-Oxley" to CEOs, and you're likely to set off angry fulminations against government regulation. They'll complain that it takes too much time to comply with the complex law that requires corporate officers and directors to be more vigilant and accountable to investors. It takes too much paperwork to document company controls. It costs way too much money.

Maybe so. But the record shows that since the passage of the Sarbanes-Oxley Act on July 30, 2002, accounting problems have emerged at many companies. While Corporate America's burden of adjusting to higher accounting standards may not be light, it is necessary. It's time for CEOs to stop complaining and suck it up.

Lest we forget, shareholders are still getting mugged by corporate accounting scandals. Nortel Networks is in trouble because of alleged manipulation of its books that inflated profits. Three top executives were dismissed in April, and profits are likely to be restated. Royal Dutch/Shell Group was found to be overbooking oil and gas reserves on a huge scale, news that caused its stock price to fall sharply. Symbol Technologies settled an SEC enforcement action chargi company with accounting fraud while the SEC indicted former executives.

CEOs say that the cost of compliance is onerous. Yet hard to see much impact. Earnings are at record levels, many companies have billio cash. Moreover, implementi Sarbanes-Oxley is mostly a time cost. Once the complia structures are in place, annu costs should fall.

Investors are still getting mugged by corporate accounting scandals

Unfortunately, progress is The Public Company Accou Oversight Board (PCAOB) re surveyed 500 big companies are putting new financial co in place sluggishly. Nineteen percent haven't even started have just begun; 15% are ab ready to go; 20% are beginning to implement the rules are almost compliant; and a mere 5% are fully compli

Not all of it is the fault of CEOs. There is a lot of conf over what the law requires. Consultants are jumping in frightening boards of directors into covering every contingency at huge expense. A Business Roundtable s of 150 big-company CEOs showed that half thought ful compliance would cost from $1 million to $5 million, w others estimated $10 million. The PCAOB and its head, William J. McDonough, should work to provide better financial guidelines for companies.

So Much Cash, So Much Caution

CORPORATIONS ARE sitting on a mountain of cash. Companies in the Standard & Poor's 500-stock index had more than $500 billion in cash and short-term investments at the end of the first quarter (page 30). With earnings at record levels, why aren't CEOs spending more on new investments? At this stage in the recovery, why aren't they taking more risks?

The answer appears to be uncertainty. Until key political and economic issues are resolved, the current lull in the economy may be more prolonged than anyone expects.

What's bothering CEOs? The close election, for one. Just months ago it appeared that President Bush's reelection was a lock. Now, with John Kerry picking popular John Edwards as his running mate, the race is very close and the stakes for tax, regulatory, fiscal, and health policies could be high. The good news: This uncertainty weighing on CEOs will end on N

Not so for most other unknowns. The security prepa for the Boston and New York political conventions is a reminder of how real the terrorist threat remains. Septe 11 traumatized the nation, and concern that the U.S. ma not be prepared continues to sap confidence. Iraq, of co adds to the worry. Lack of preparation for the occupati the resulting insurgency has damaged the Bush Preside The Administration's reputation for managerial compe has been shaken. The country's prestige abroad has als damaged. Executives who run global corporations now fierce anti-Americanism around the world. It is unsettli

The economy, too, has question marks. One surprise sudden appearance of inflation. Oil prices have soared. China's growth has increased demand—and prices—fo commodities. And prices for eggs, milk, health care, mo coffee, much of what people buy—have unexpectedly g Now interest rates are starting to rise. The current paus the economy is partly the result of consumers stepping When will they return?

The truth is that CEO reluctance to invest reflects an underlying fear about the future that has not totally go away since September 11. The nation's wounds have no completely healed. Iraq appears to have made us feel vulnerable again. Much remains to be done before CEO confidence—indeed, national confidence—is fully resto

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A CEO'S LAST STAND

Scott McNealy knows he made many mistakes. Is it too late to recover?

BY JIM KERSTETTER & PETER BURROWS (P.64)

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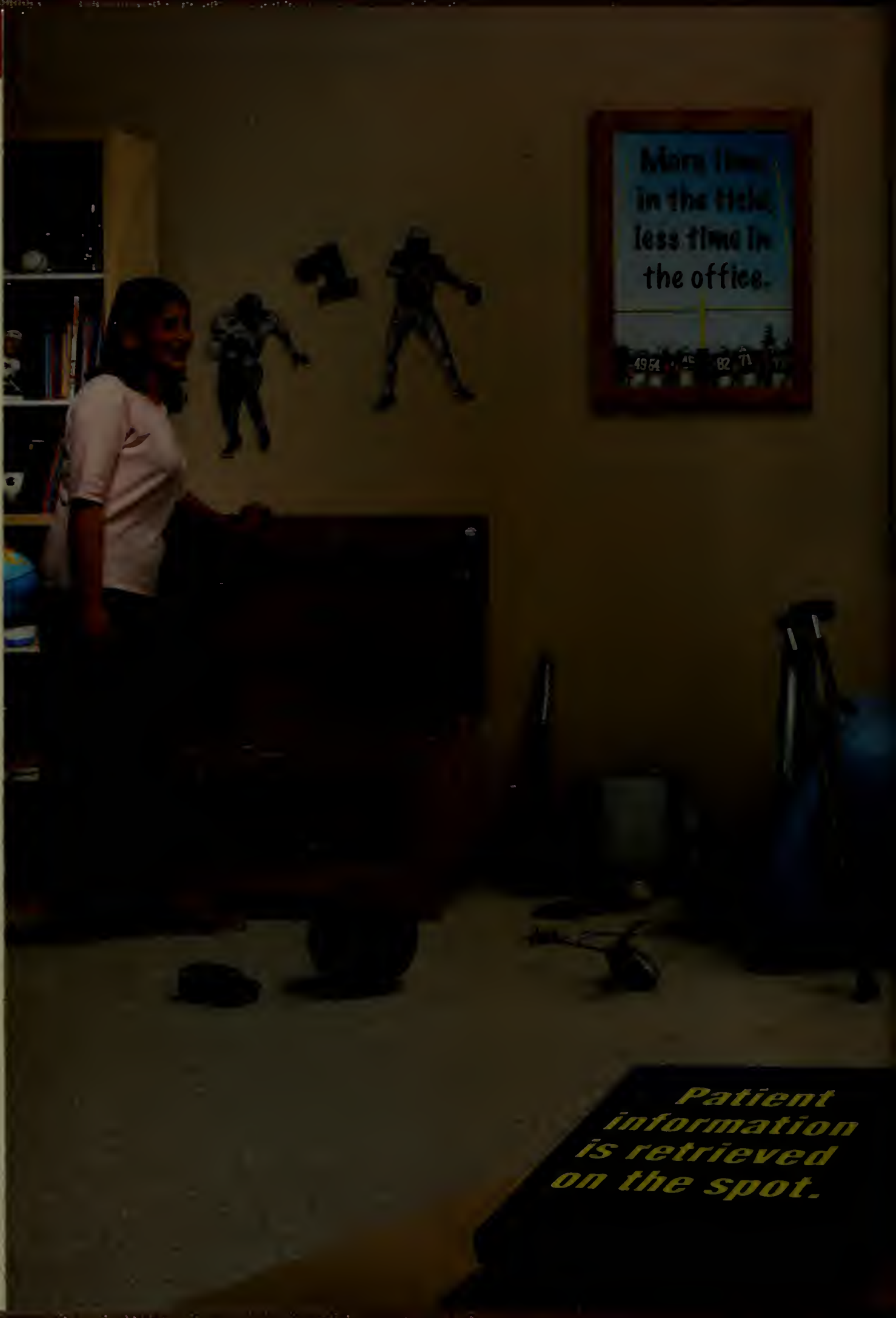

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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Special Report: Technology and Medicine

Networked devices that keep tabs on elderly patients living at home could soon provide better care—and cut costs. Plus: The push toward a paperless health-care system, and keeping medical records secure

June's Report Card for the IT 100

The first of a monthly installment tracking the performance o members of *BusinessWeek*'s Info Tech 100. The top stars year-t date include Autodesk and Yahoo! (with Apple not far behind Among the laggards: Lexar Media and Sandisk

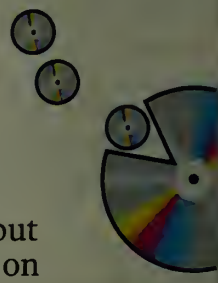
Memo to Bankers: You Had Better Woo Your Board

These days, banking chiefs ignore their boards of directors at their own peril. That's a lesson Credit Suisse First Boston's John Mack just didn't learn. Why do so many top financiers make the same mistake?

Reason to Hope for Greater India

The new Congress Party-led coalition government appears determined to fulfill its vow to improve life in rural areas whi moving the whole country forward. That's leading to rising optimism throughout the country

Software Makers: Soon They'll Be Fewer



As earnings fall and competition stiffens, many smaller companies will be faced with no choice but to merge or die. The hunt for partners is already on

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BWK7_04

JP Front

"Tax cuts for wealthy thugs like me are criminal."

–Paul Newman, at a Kerry-Edwards fund-raiser

ED BY IRA SAGER

RTH KOREA

FORMS ARE ARTING BEAR FRUIT

TH KOREAN LEADER Kim Il's fledgling economic ms may be taking root. country's economy grew dest 1.8% in 2003, but he fifth consecutive year owth after a decade of raction in the wake of the

CROPPING UP Open markets

pse of the Soviet Union. vo years ago, Kim started g citizens open small nesses such as restaurants bakeries. Last March, he introduced 300 markets where licensed individuals and companies can trade goods. And companies may now retain some of their profits and pass them along to employees as bonuses. This incentive-based system has spurred some companies to temporarily move workers to more profitable enterprises.

The reforms helped boost manufacturing output by 2.6% last year, up from a 2.0% fall in 2002. "The economic changes in the past couple of years are much greater than in the previous 50 years," says Jo Dong Ho, of Seoul's **Korea Development Institute.**

Still, North Korea is one of the world's poorest countries, and that won't change without outside help. But aid won't start to flow unless the North shutters its nuclear weapons program. Until then, the North's isolation and stagnation are likely to continue. *–Moon Ihlwan*

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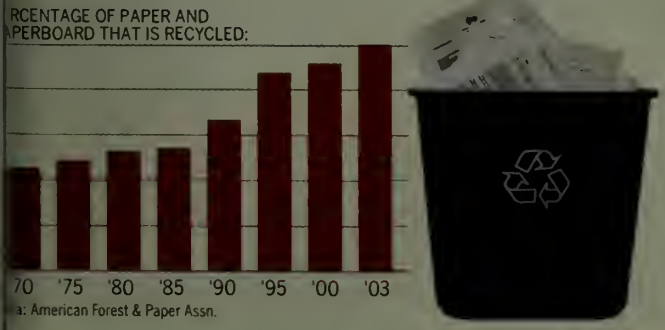

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BLODGET His new company won't do stock research

AFTERLIVES

A New, Improved Henry Blodget

HENRY BLODGET IS BACK in the research business—sort of. *BusinessWeek* has learned that the former **Merrill Lynch** analyst has a fledgling company that plans to provide industry analysis and consulting services.

Blodget, who became an emblem of boom-era hucksterism for hailing Net stocks, was barred for life from the securities industry in 2003. An SEC spokesman declined to say whether Blodget's plans violated the terms of his settlement. Blodget says his firm, **Cherry Hill Research,** won't do stock research, in compliance with the agreement. Legal experts say the venture sounds permissible but note it's a gray area of the law.

New York-based Cherry Hill has taken its first steps with a research paper on initial public offering methods distributed free to academics. "To say it is garage-based would be an insult to real companies located [in garages]," Blodget writes in an e-mail. A push for business is a ways off, if ever, says Blodget, who's keeping busy with freelance writing work.

Judging by the disclosure page in the paper, it appears Blodget has learned from his travails: "We can guarantee that our opinions, conclusions, and predictions will sometimes be wrong.... Sometimes [errors] will result from mistakes, ignorance, and/or idiocy." How's that for disclosure? *–Brian Hindo*

UP Front

SLUGFESTS

WHY IS THIS MAN BASHING CalPERS?

THOMAS DONOHUE, president of the **U.S. Chamber of Commerce,** has come out swinging at the $162 billion **California Public Employees'**

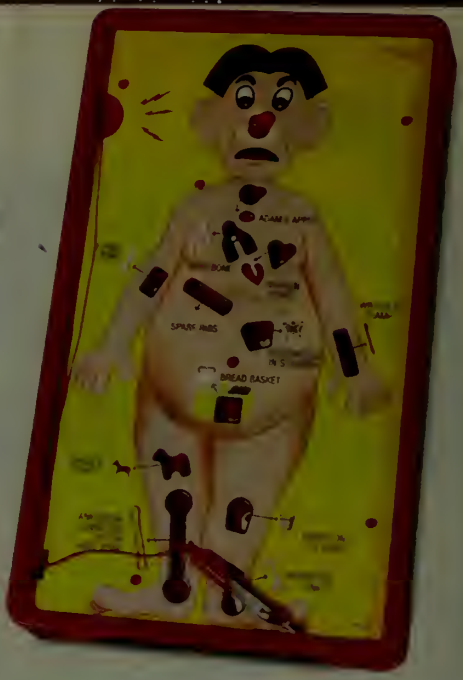
DONOHUE "No secret"

Retirement System. In a recent opinion piece in the *San Francisco Examiner*, he chided the activist pension fund for being a front for organized labor trying to needle Corporate America every chance it gets. But as a subsequent story in the rival *San Francisco Chronicle* pointed out, Donohue may have his own agenda—one he didn't disclose to readers.

Donohue sits on the boards of **Union Pacific and Qwest Communications,** two companies that have been criticized by pension fund activists for overcompensating executives while underperforming. Among the big shareholders in both companies is Denver businessman Philip Anschutz, who happens to own the *Examiner*.

Donohue made at least $160,000 per year from those two board positions and owns stock or options on 27,000 shares of those two companies. Anschutz declined to comment. Says Donohue: "My service on boards is no secret, and my agenda is straightforward."

–Christopher Palmeri



ILL WINDS

DISEASES IN YOUR FUTUR

People who l to obsess ab their health might want t check out a r Web site fro Harvard Univ sity's School of Public Health: Your Diseas Risk (www.your-diseaserisk.harvard.edu/) Visitors to the site fill out a detailed questionnaire to find out their chances of developing five of the most devastating ailments in America: heart disease, stroke diabetes, osteoporosis, and 12 varieties o cancer. The site also offers personalized ti on how they might reduce their risk. Of course, the site is not meant to replace a visit to the doctor, but it could be a wake-u call for the "What, me worry?" crowd.

–Catherine A

BOARD MOVES

FRESH AIR FROM THE OUTSIDE

NEW RESEARCH provides ammo to support reforms that require a majority of directors to be independent. According to a study in the May/June *Financial Analysts Journal*, having a high proportion of autonomous directors on boards and oversight committees correlates with a drop in fraud.

The study, which analyzed 133 companies accused of fraud between 1978 and 2001, also cautions that the presence of "gray" directors —such as family members without direct business ties— increases the likelihood of wrongdoing. *–Seth Porges*

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UP Front

FACE TIME

MICHAEL CURRY

HOLDING COURT —IN CLASS

Michael Curry had lots to talk about at Richmond's Virginia Commonwealth University, where he has just finished teaching a sports-business seminar. He's no ordinary prof: A 6-foot-5-inch Toronto Raptors forward, Curry, 35, is enmeshed in the latest round of labor negotiations as president of the National Basketball Players Assn.

Curry, who spent his summers picking up a master's degree from Virginia Common-wealth in sports leadership, taught his 22 graduate students the nuances of contract negotiation, drafting, and managing top athletes. Fellow NBA players Grant Hill and Spencer Haywood, plus union Executive Director Billy Hunter, were guest speakers during the weeklong class.

The 10-year NBA vet vows to spend "two more good years on the court." Then he may take to the classroom for good. With Shaquille O'Neal campaigning to become the union president, Curry could soon be free to pursue his "personal goal" of a PhD or a management gig in the NBA. Or both. *–Erin Chambers*

FASHION NOTES

IS THAT A PHONE YOU HAVE ON?

OVER THE YEARS, the cell phone has gone through changes even a chameleon would envy. Now get ready for another big makeover: Cell phones are being cleverly concealed in objects such as watches, jacket lapels, and even earrings. Already available in Europe and Asia, wearable cell phones will start making their way into the U.S. in the next year. By 2007, 20% of U.S. cell-phone users could well be donning phones, says Michael King of consultancy **Gartner.**

Much of the action so far is in Asia, where watchmakers **Seiko** and **Fossil** sell watch-phone combos. When Japanese **NTT DoCoMo** introduced a wristwatch phone from Seiko last May, it sold out its inventory of the $300 product in 20 minutes. Cell-phone maker **Samsung** has begun selling its own wristwatch phone in Asia.

In Europe, chipmaker **Infineon Technologies** and apparel maker **O'Neill** have developed a snowboarding jacket with a woven-in MP3 player, keyboard, and headset (the microphone is integrated into the jacket's collar) that works with a phone in the wearer's hand or pocket. The jacket, priced at around $600, will hit European stores in September.

For all the activity abroad, many cell-phone makers believe today's wearable d[illegible] are far from optimal. Bu[illegible] could change soon. NTT DoCoMo is developing t[illegible] nology called FingerWh[illegible] that uses a bone in the h[illegible] to make a wristwatch ph[illegible] easier to operate. When [illegible] arrives, the phone sends [illegible] brations through the bo[illegible] the index finger. Slip the [illegible] into the ear canal, and th[illegible] vibrations turn into voic[illegible] Users would make calls [illegible] send text messages by ta[illegible] their palms in certain w[illegible] Now that's true cell-pho[illegible] evolution. *–Olga*

SNOW JOB An O'Neill jacket conceals a phone headset

CAMPAIGN 2004

PUT YOUR MONEY WHERE YOUR VOTE IS

HOW DOES JOHN Edwards alter the Presidential race? Betting site **Tradesports.com,** based in Dublin, gives George Bush a 51% chance to win, down from 57% before John Kerry added Edwards to the ticket. A Bush victory would pay out $1.49 on the dollar at Tradesports, which takes bets on athletics, politics, and finance.

There's easier money to be had. Tradesports places Kerry's chance of wrapping up the Democratic nomination at 98%. So a $1 million bet would yield a tidy $20,408 profit.

A company rep warns that huge bets will take down odds further, and that gamblers should be prepared to lose any money they wager. It's just a 2% return, but a whole lot less risky than the stock market. *–Seth Porges*

THE STAT

28

The percentage of Corporate America's chief information officers who say they are consideri[illegible] using Linux on the desktop for their companies

Data: Merrill Lynch Inc. survey of 300 C[illegible] in June 2004

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Mr. Consumer Electronics

AKIO MORITA worked frantically as chaos closed in on Japan in mid-1945. A young Navy lieutenant, Morita had joined a team of scientists to perfect new thermal-guidance weapons and night-vision gun sights. Japanese technology to the rescue? That illusion evaporated when atomic bombs of the U.S. Armed Forces abruptly ended the war.

But Morita, a physics grad of Osaka Imperial University, saw nothing but promise in Japan's technological prowess. In 1946, he and a young engineer, Masaru Ibuka, launched a company with the clunky name of Tokyo Telecommunications Engineering Corp. In 1958 they renamed their venture Sony (it sounds like the Latin word for sound) to appear less Japanese.

The renaming was classic Morita, who was as much a marketing genius as a tech wizard. Sony would prove to be the most innovative company in postwar Japan, ushering in numerous breakthroughs in consumer electronics—from the Walkman portable stereo/cassette player to the all-important compact disk, which it developed with Philips Electronics. But Morita also knew the art of the pitch. When launching the Walkman in the U.S., Morita had special white shirts made with oversized pockets for his salesmen—to prove that the original device could easily be carried. In the 1960s, when "Made in Japan" meant shoddy goods to many U.S. customers, Morita moved himself and his family to New York to sell his company's products and to learn the language and ways of what would eventually be Sony's biggest market. Morita was one of the first in Japan to encourage company executives to learn English—a shrewd move that increased Sony's aura of internationalism.

Japan Inc. was proud of Morita, but was never quite sure what to make of him. As a young man, he bucked the established norms for a first son by walking away from the family sake business in Nagoya. Instead, he gambled his future on a startup based in an abandoned department store in a bombed-o section of Tokyo. At first the going was rougl Ibuka and Morita ferried supplies to headquarters in a Datsun truck they picked u on the black market for $100. An electric rice cooker never got off the ground, and Sony's f tape recorder was an expensive monster that weighed 75 pounds and proved a tough sell i hardscrabble postwar Japan. Later on, thoug Morita and Ibuka became fascinated by the v of William B. Shockley at Bell Laboratories, where the transistor was developed. In 1953, paid $25,000 to license the technology and a four years rolled out a portable transistor radio that became smash hit. Forty years later the transistor radio maker had morphed into a global giant with $72 billion in sales.

Sony's genius ushered in the portable transistor radio, the Walkman, and the CD

Morita didn't get everything right. Sony's early Betama standard for videocassette recorders got crushed by the VI format championed by such rivals as Matsushita Electric Industrial Co. And Morita's backing of Sony's $3.7 billion acquisition of Columbia Pictures Entertainment in 1989 resulted in huge initial losses. Five years after Morita's de from a stroke, Sony is battling to regain supremacy in an industry where companies such as Samsung Corp. have learned the vocabulary of cool, too. But Sony created the consumer-electronics industry as we know it, and it's Mor dazzling success that all rivals still strive to emulate. ■

–By Brian Bre

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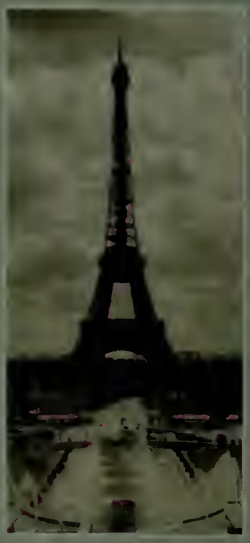

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"This scenario will result in ... even greater offshore investment."

–Rich Woods
Sarasota, Fla.

A RECESSION FOR THE AVERAGE CITIZEN

IN MY OPINION, the Greenspan/Bush economic policy will fail because of the increasingly negative impacts realized from macro multiplier effects ("High stakes for Alan Greenspan," Editorials, July 5). As domestic economic activity and sales are increasingly satisfied by imports, offshore employment, and offshore investment—to the detriment of domestic equivalents—these negative multiplier effects will eventually curtail domestic consumer spending. With lower corporate tax revenues and decreased tax rates for the wealthy, the average citizen's disposable income drops, as the domestic economy is forced to absorb more debt and higher interest rates. Citizens will be forced to make up the difference in lost state revenues, where borrowing is not available as an alternative.

During the '90s, macro multiplier effects had a very positive effect on the domestic economy. More recently the emphasis on supply-side economics and increased tax benefits for large corporations has reduced costs and competition while increasing unemployment. Additional multiplier effects are having a negative influence on the economy: foreig tanglements, inflation realized fro creased economic concentration, hig prices, and higher medical bills. The c continue, as the favored are rewarde

This scenario will result in decre consumer spending and economic r sion for the average citizen, with h productivity (fake productivity, business processes are being shippe shore), greater incomes for the we and even greater offshore investmen

–Rich W
Sarasota

DON'T PUNISH COMPANIES FOR SELF-CRITICISM

"COVERUP AT BOEING?" (Legal Af June 28) missed an important point cording to the article, Judge Pechma dered Boeing to disclose a series of i nal salary analyses, which the judg showed pay disparities based on ge The shortsighted message of this c that an employer may be better off does not analyze its pay practices. courts, but apparently not this one, recognized a privilege for an emplo self-critical analysis in order to enco employers freely to examine and co

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ORRECTIONS & CLARIFICATIONS

"king hospitals cry uncle" (People, June correctly reported the date that Medical ngs Insurance Co. was founded. The pany began operations in 1997. J. Patrick ney, chairman and CEO of Medical ngs, says he did not hold any stock in her company, Golden Rule Insurance when Golden Rule was sold in 2003. The ry also should have noted that Medical ings has brought a federal antitrust law- against several Florida hospitals alleging e fixing. In its disputes with hospitals, dical Savings contends that the hospitals rcharge its policyholders. Medical vings says it has a policy of defending icyholders from hospitals' attempts to ect unpaid charges. The "debt forgive- s" that the story reported Medical ngs received from Tenet Healthcare p. referred to those contested charges was not meant to imply that Medical ngs had borrowed money from Tenet.

obal compact, little impact," a story ut the U.N.'s voluntary corporate ponsibility plan (Social Issues, July 12), oneously listed Newmont Mining Corp. ong the companies currently facing civil wsuits in U.S. courts related to abetting ious rights abuses.

r practices. Penalizing an employer ts attempts to comply with the law ermines the purposes of the Civil ts Act of 1964, which encourages ntary compliance. Is this the message we really want to send?

–Bruce McLanahan
New Canaan, Conn.

BE THE VOTING SYSTEM T SO SKEWED

RESPONSE TO "Does your vote mat- " (Special Report, June 14), reader mas J. Cassidy suggests that the "win- take-all" system grossly skewed the ome of the 2000 Presidential election. idy advocates a system like the one l in Nebraska and Maine ("How to fix ewed system," Readers Report, July 5). points out that, with such a plan, rge W. Bush would have won only 14 lorida's 25 votes. But Cassidy stops t of examining the effect nationally. ead of winning all of California's 54 s, Al Gore would have taken 31 to h's 23. Gore would have won New , but Bush would have taken 4 of that e's 33 votes. And Pennsylvania, which its 23 votes to Gore, would have been or-close 12-to-11 Gore victory: Bush won 11 districts to Gore's 10, but Gore's overwhelming margins in Pennsylvania Districts 1, 2, and 3 propelled him to a close victory in that state's overall vote.

Although it is difficult to obtain votes by district for every congressional district, the evidence indicates that had every state apportioned its Electoral College votes, Bush would have won 293 votes to Gore's 245, thus magnifying, rather than diminishing, the discrepancy between the popular and electoral vote. With such a system, gerrymandering in particular would have increasingly important effects on future Presidential elections.

Count me as a supporter of our present system, which allows states to choose the "winner-take-all" system or any other apportionment of its Electoral College votes, as it prefers.

–Robert Jeffery
Atlanta

DELAWARE'S LAWYERS ARE HELD TO A HIGH STANDARD

IN "A FREE PASS for attorneys" (Legal Affairs, June 28), Mike France says: "Duty to the courts is monitored by lax judges and state bar associations." But Delaware lawyers get no "free pass." For three consecutive years, the U.S. Chamber of Commerce has ranked Delaware's legal system as the best in the nation, in part, I submit, because of the high standards to which the Delaware judiciary holds Delaware lawyers, including with respect to the discovery process. The Delaware Supreme Court, and not the Delaware State Bar Assn., has inherent and exclusive authority to discipline members of the Delaware bar. In addition to the professional obligations imposed by the Delaware Lawyers' Rules of Professional Conduct, the court has adopted Principles of Professionalism for Delaware Lawyers.

–Andrea L. Rocanelli, Chief Counsel
Office of Disciplinary Counsel
Supreme Court of the State of Delaware
Wilmington

A MONUMENTAL OCCASION IN A MESSY LIFE

IN "MESSY LIFE, messy memoir" (News: Analysis & Commentary, July 5), I am appalled by the callous statement, "Does anyone really care that on Apr. 29, 1994, Clinton hosted Native American and Native Alaskan leaders on the South Lawn of the White House?" On this monumental occasion for all Americans, Clinton became the first sitting U.S. President to host leaders of all the federally recognized tribes at the White House. In addition to proposing an unprecedented number of economic incentives, community-development initiatives, and increased budget allocations to Indian nations, he became the first U.S. President since Franklin D. Roosevelt to visit an Indian reservation. He also named more than 70 Native Americans to his Administration.

–Stacia N. VanDyne
Columbia, Mo.

DESIGN: DUBIOUS CLAIMS FOR A CHEVY TRUCK?

IN "THE BEST product designs of the year: Winners 2004" (Annual Design Awards, July 5), I was surprised to see the Chevy Super Sport Roadster a gold-medal winner. I agree it is gorgeous to look at, but the tests I have read indicate that it is neither a good car (small inside with a fair amount of chassis flex) nor a useful truck (small bed and low sides).

–Andrew Thompson
Wyoming, Ohio

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Dirty Rats, Cultural Icons

PUBLIC ENEMIES **America's Greatest Crime Wave and the Birth of the FBI, 1933-34**
By Bryan Burrough; Penguin Press; 592pp; $29.95

After an 80-mph "wild running gunfight" with police outside South St. Paul, Minn., in April, 1934, John Dillinger and two pals need a less-conspicuous getaway car. Using a pistol, one member of the gang flags down a passing family on a quiet side road. As he steals their Ford, Dillinger's partner apologizes to the driver, a power-company manager on his lunch break, enviously telling the man he is lucky to have a nice job and family. And, even as his other partner writhes in excruciating pain from a police bullet, the ever-polite Dillinger takes a minute to pat the couple's baby on the head. "Don't worry," says this son of an Indianapolis grocer. "We like kids."

Ah, the gentleman bandit. We meet a few in *Public Enemies: America's Greatest Crime Wave and the Birth of the FBI, 1933-34*, Bryan Burrough's spellbinding new account of America's first War on Crime. There are also psychopaths, such as "Baby Face" Nelson, who cackles during robberies and whose cronies fear he might shoot them and take all the loot. And there are even would-be poets, such as the histrionic Bonnie Parker, who writes verse for her mother in between stickups at gas stations and banks on which she accompanies the murderous Clyde Barrow. Anticipating her death, the former waitress asks her widowed mom to bring her body home to West Texas to spend "a long, cool, peaceful night together before I leave you."

Some of the rich details are culled from dubious news accounts and books written years after the events. Others are from ostensibly more reliable FBI files and the recollections of descendants of those involved. Weaving them together, Texas-born Burrough, who made his reputation with *Barbarians at the Gate*, the 1990 account of the RJR Nabisco leveraged buyout, offers a rip-roaring, day-by-day account of a particularly lawless two-year period. While many Americans struggled with the privations of the Depression, the mugs, molls, and hangers-on of Burrough's account ranged through the Midwest, the California wine country, and Florida. There, they knocked over banks, kidnapped rich people, and—for a remarkably long time—eluded lawmen. "Pretty Boy" Floyd, Ma Barker, and "Machine Gun" Kelly all put in colorful appearances. Where the book falls down is in making sense of America's fascination with such social misfits.

Perhaps it has something to do with the way these gun-toting, wise-cracking gangsters made fools of J. Edgar Hoover and his rather green "G-men." The FBI, first created in 1 to probe antitrust cases for the Justice Dept., was in the far from the crime-busting machine of lore. The band of college boys and "cowboys," which a Milwaukee newsp once branded "comic opera cops," at first doesn't even h the right to carry guns. The villains, the author suggests the agency to grow up, in effect creating the modern FB

Such insights, though, are secondary to action, includ close-up accounts of astonishing escapes. For sheer braz ness, little compares to Dillinger's Mar. 3, 1934, breakou a jail in Crown Point, Ind. Armed with a wooden gun an helped by another inmate brandishing a toilet plunger, t gangster bluffs his way out. He stops his jail mate from hitting a 64-year-old janitor, remarking: "Contrary to wl people say, I'm no killer." But the next month we see Dillinger's gang shoot its way out of a trap backwoods Wisconsin lodge, as ill-prepare men close in. A civilian and an agent die— many people to fall in Dillinger's spree.

Burrough also offers vivid reconstructio bold daytime robberies. Gangsters, pumpe with adrenaline, rake bank interiors and n storefronts with tommy guns. They take hostages as they make carefully planned "g out of towns such as South Bend, Ind., and Sioux Falls, S.D. And we see them hole up pals in Chicago apartments and in Midwes lakeshore cottages, at times having tearful meetings with relatives or mooning over girlfriends. The Ma Barker-Alvin Karpis ga drops in on resorts in Miami and Havana. along, family and friends— well as corrupt lawyers, do and cops on the take—eas way. Dillinger, his looks alt by plastic surgery, wanders freely in East Chicago, Ind. until a reward-hungry wo friend betrays him and the plug him outside a theater July 22, 1934. Some 5,000 people come to see him bu in Indianapolis.

> They eluded the law and captivated Depression-era America

The action is nonstop—and sometimes, the rat-a-tat p can overwhelm a reader. But *Public Enemies* is thin on analysis. Why did these villains become celebrities? Why they become villains in the first place? Aside from a few g suggestions—Depression-era resentment of banks, youth prison experiences—Burrough avoids such issues. Still h volume is a model of narrative journalism and an often gripping read. Short on the "why," *Public Enemies* does a bang-up job on the "how." ■

–By Joseph W

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BY STEPHEN H. WILDSTROM

Sour Notes on PC-Stereo Networking

I have a lot of digital music stored on a computer upstairs at home. I also have a good stereo system downstairs and a Wi-Fi wireless network. You might think it would be a simple matter to get the music to the stereo ov the network. It isn't—and the reasons help explain why the convergence computing and consumer entertainment is slow and difficult.

I tried out two players designed to transmit music wirelessly around the home: the Netgear MP101 Wireless Digital Music Player (around $120) and the Linksys Wireless-B Music System (about $180). They are similar designs, but the Netgear will work only when plugged into a standard stereo system, while the Linksys can work either that way or with its own powered speakers.

To set either up, you install a small server program on the Windows PC where your music is stored. (Macs are not an option for Netgear or Linksys.) When you connect the player to the wireless network, it locates its server, pulls in music files, and plays them on your stereo. The players have LCD displays that are a bigger version of what you see on an iPod. Using a remote control, you can select music by album, artist, song, genre—or by any playlist on your PC.

On a good stereo system, audio flaws that are tolerable on a PC's cheap speakers can be glaring. But that wasn't a problem with my music collection, which consists mainly of CDs that I have converted to the MP3 format at high quality. These files sounded nearly as good as the original CDs, although wireless network issues caused an occasional hiccup. The Netgear player can use both standard Wi-Fi and the much faster 802.11g version, which should avoid such problems.

Linksys: Good sound, but painfully difficult to set up

ALL WOULD BE WONDERFUL if it weren't for two huge problems: setup and security. The Netgear system is relatively simple to install if you have never touched the security settings on your Wi-Fi network. But for the many wise users who insist on locking their Wi-Fi networks, getting started will be a lot harder. Depending on your network, you may have to enter your password as a string of 10 or 26 "hexadecimal" digits, a trick known only to programmers. The Linksys player is a pain to set up, regardless of how you manage your Wi-Fi. I was forced to resort frequently to trial and error when the instructions in the "quick start" guide didn't work. Linksys' one advantage: You can wire it temporarily to your PC while you punch in the various settings; Netgear forces you to perform this tas with a remote control.

Things get much worse if you run built-in Windows firewall or a produ such as ZoneAlarm on the PC that ac the server. The firewall, doing exactly what it is designed to do, blocks requ from the player. Linksys offers the unwise suggestion to disable any fire on the PC; Netgear gives instructions setting up common firewalls that are too complicated for most people to follow. And matters are going to get a worse when Microsoft issues an upd to Windows, probably in August The update automatically turns new Windows Connection firewa and complains vigorously if you to disable it.

There is hope. Two new player the Apple AirPort Express ($129 and the Roku SoundBridge ($22 will use an Apple networking technology called Rendezvous th promises simple and secure connections for both Macs and Windows. In the fall, Microsoft's own Media Center Extender sho simplify things with a new standard called Universal Plug and Play AV.

Networked entertainment devices could bring huge benefits to consumers and to the computer and consumer-electronics industries. But if manufacturers want to move them beyond the techie fringe, they will have to make setu and security drop-dead simple.

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BY ROBERT J. BARRO

Uncle Sam Wants You, But the Draft Is History

It has been more than 30 years since America used conscription for the military. People are worried that the Iraqi intervention and an enlargem of the military will lead to the reintroduction of the draft. Some lawmake have even proposed a draft, but it probably will not happen. The impetu for switching to an all-volunteer force was the unpopular Vietnam War.

The political opposition to conscription strengthened, particularly when the introduction of a lottery system in 1969 ended most preferential treatment for college students and designated occupations. Apparently, the draft then hit men who were most opposed to military service and were also politically powerful.

A new study, *Conscription as Regulation* by Casey Mulligan and Andrei Shleifer of the National Bureau of Economic Research uses international data to establish the factors that lead countries to use a military draft. Two key determinants stand out: whether a nation's legal system is modeled on French statute law or the British common-law structure and the size of a country's military force.

THE FRENCH SYSTEM, INTRODUCED under Napoleon and derived from Roman law, relies on statutes, comprehensive codes, and detailed input from legal scholars. The British system focuses more on decentralized dispute regulation by judges, legal precedent, and voluntary contracts. In earlier research, Shleifer and his co-workers have argued that the differences in legal arrangements explain a lot of the country-to-country variations in economic performance and financial systems. Typically, the researchers found that the French system—and other forms of statute-law systems, namely Germanic and Scandinavian—were inferior to the British one. These results have received enough attention to prompt an official protest by the French executive director of the World Bank. Although I am instinctively appreciative of findings that irritate French public officials, I have nevertheless been skeptical about the empirical results on legal systems. For one thing, France and Britain are currently at similar levels of economic development. So, how could the differences in legal origins be crucial for economic growth?

Mulligan and Shleifer have now convincingly isolated one area in which the differences in legal origins matter: French-style statute-law countries are much more likely to use the military draft. Probably the reason is that these countries have already established a large state administration for regulation. Given this apparatus, administering conscription is relatively straightforward; in effect, the draft is merely another form of regulation.

Out of the full sample of 164 countries, 69 (42%) had draft in operation in 1996. But for the 48 British legal-or countries, 39 (81%) had no draft. Among the 95 countri with a draft, the 9 British legal-origins ones tended to ha nonpreferential systems, whereas the 86 French legal-or ones were more likely to have complicated systems with exemptions for students. In fact, 13 of these countries ha legal buyouts from conscription. In this respect, the cour resembled the U.S. during the Civil War.

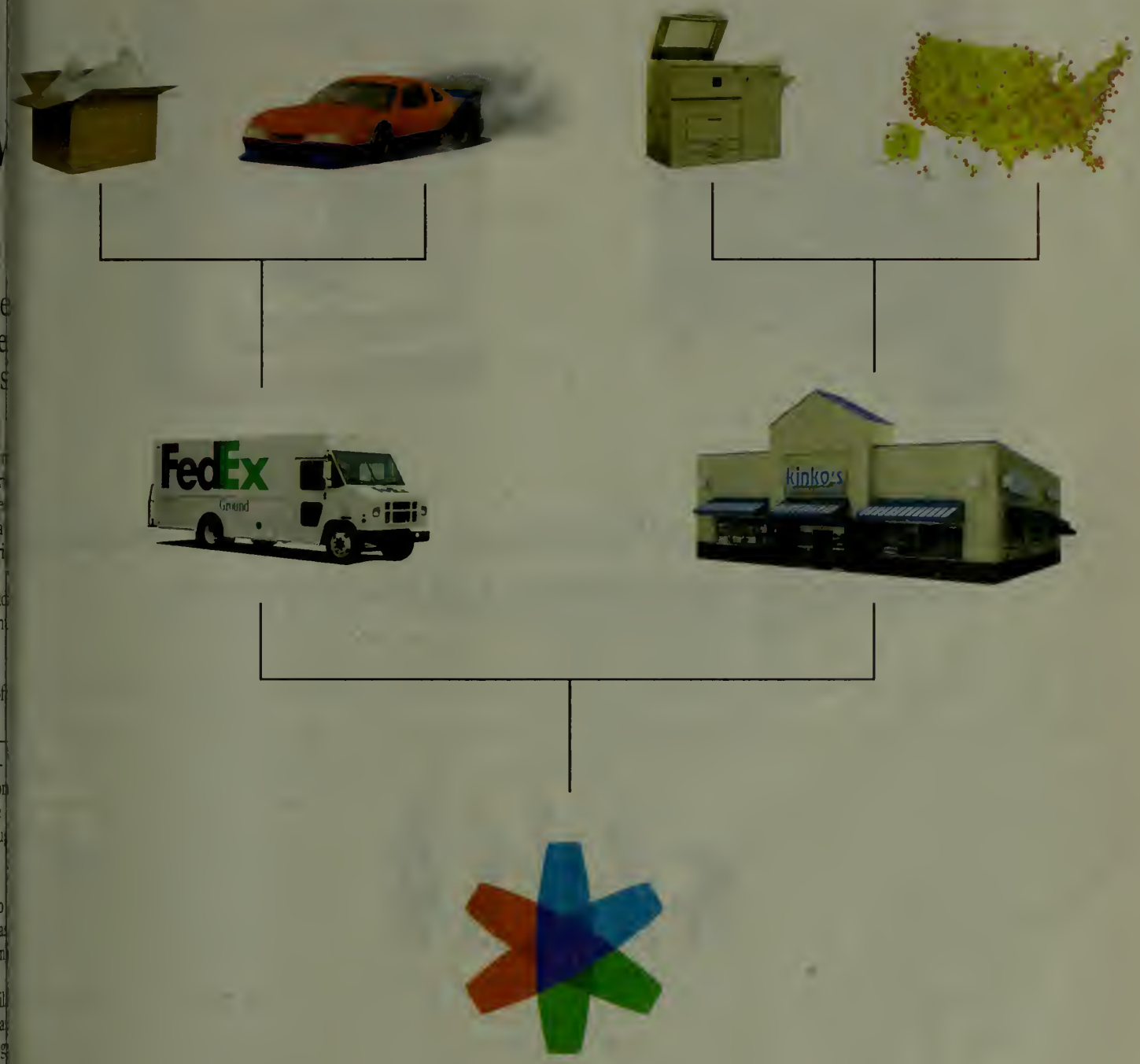
Another factor that predicts a draft is the size of the military. A country that wants to have a large fraction o its population in the military is more likely to use conscription. Thus, in the U.S., a draft was more likely— despite British legal origins— when the size of the armed fo was about 3 million, as in the 1960s, compared with the rou 1.4 million today.

A global study of conscription makes a new U.S. draft look unlikely

Countries with larger populations are more likely to the draft. The reason is that, a with other forms of regulatior running of an apparatus to administer conscription entai large fixed costs. These costs a more likely to be worth paying when they can be spread over larger scale. Finally, poor countries are no more likely th rich ones to use a draft.

Putting all the results together, it turns out that the cha of a draft under current conditions in the U.S. is about on three. If the military were to double in size—to levels of th Vietnam era—the probability would rise to nearly one in However, with a more likely smaller increase in the milita the odds of the draft being reinstated would remain belov 40%. Of course, I am assuming that the U.S. does not swi to a French-style legal system. ■

Robert J. Barro *is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu).*



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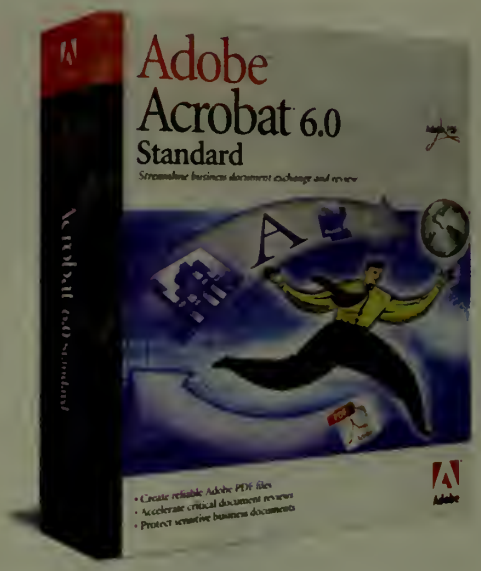

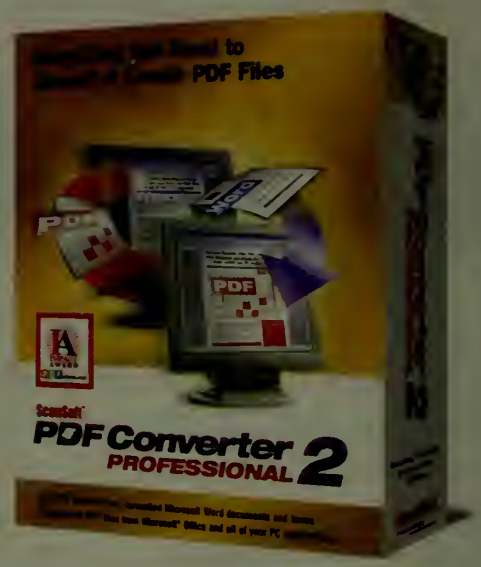

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JAMES C. COOPER & KATHLEEN MADIGAN

The Trade Deficit May Soon Cause Less Pain

weaker dollar and stronger global demand will slow down the beast

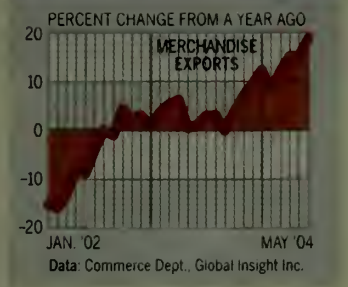
U.S. ECONOMY The trade deficit has been a thorn in the side of the S. economy for the past seven years. Over that time, the ever-dening gap subtracted, on average, 0.7 percentage points per year om overall economic growth. Except for the larger deficit, the onomy would have grown 3.8% annually instead of 3.1%. The ort side of the ledger has accounted for much of the ening. The U.S. led the global upturn, with help from na, resulting in sharply faster growth in U.S. demand mports, while U.S. exports were stuck awaiting better nand from overseas and a more competitive dollar. he trade gap's drag on U.S. growth will likely tinue, but the May data offer some hope that the rate eterioration is easing. World growth is accelerating, J.S. exports are picking up speed. Yet at the same e, domestic demand is coming off the boil, after being ted up by steep tax cuts and super-low interest rates. result, import growth is bound to slow somewhat. Still, any improvement in the trade balance this ning year will be painfully slow. One reason is rency patterns around the globe. True, the dollar has en 22% from its peak in early 2002, as measured inst several major currencies. That is lifting export petitiveness and the prices of many imports. But it's the major economies that are causing the deficit to loon. The U.S. trade gap with the other members of Group of Seven has accounted for only 12% of the l deficit's deterioration in the past three years. The bulk of the widening has come from trade with eloping nations. For example, America's growing trade with China, India, and Asia's Newly Industrialized ntries (NICs) of Hong Kong, Singapore, Taiwan, and th Korea contributed 38% of the overall gap's three-r deterioration. But China fixes its currency to the lar's level, and other Asian countries actively manage ir exchange rates. That's why the dollar is down only vs. a broader set of currencies, exerting less upward h on import prices.

Slow progress on the deficit means political pressure r trade issues, especially job outsourcing, is sure to nsify as the November elections near. Already, the ase "fair trade," typically associated with protectionist edies, is showing up in campaign speeches.

SPITE SUCH RHETORIC, there are reasons for imism in the trade outlook, especially for exports. eed, a rebound is already under way. Total exports ped 2.9% from April to May. That helped to narrow trade deficit to $46 billion, from April's record $48.1 billion. Goods exports alone were up 18.8% from a year ago. That's the fastest annual clip in more than nine years, and it's a stark turnaround from two years ago, when merchandise exports were falling 8.8% (chart).

The rebound has been widespread so far in 2004, vs. last year's first five months. For instance, of the 47 items listed under industrial materials and supplies, only three are running below 2003 levels. Others, like organic chemicals, plastic materials, and precious metals, are growing at double-digit rates.

A SHARP TURNAROUND FOR EXPORTS



Data: Commerce Dept., Global Insight Inc.

For capital equipment, by far the largest category of U.S. exports, the gains are equally impressive. Total capital goods shipments so far in 2004 are up 16.3%, with high-tech exports up 15%.

Global demand for business equipment should stay strong next year since companies in major industrialized nations are trying to mimic their U.S. rivals and boost productivity, while newly emerging economies are expanding their facilities or establishing new industries. The Institute for Supply Management reported that export orders continued to grow in June, with electronic components and equipment leading the way.

SO WHO'S BUYING U.S. EXPORTS? Not surprisingly, the two leaders remain America's neighbors, Canada and Mexico, who together purchased $122 billion in goods so far this year, a 10.9% increase from 2003. The European Union's demand for U.S. merchandise is up 12.1%, while slowly recovering Japan's purchases have risen 3.6%.

But it's the developing economies where demand for American goods is exploding. The U.S. has increased its exports to the four Asian NICs by 22.3% so far this year. Sales to China have mushroomed 37.2%, and shipments to Eastern Europe are up 41.6%.

While this year's export surge means that year-over-year comparisons may start to soften, the outlook for

global growth is solid enough that U.S. exports should continue to climb. The Bank of Japan has upped its forecast for Japanese growth into 2005. And the International Monetary Fund expects the world economy to remain very healthy. Growth in emerging markets should hit 5.9% next year, little changed from this year's 6% forecast. And the euro zone and Canada's growth rates are expected to accelerate. Meanwhile, China's efforts to rein in the expansion of its factory sector is not a worry. China will still need to purchase the kinds of capital goods that the U.S. excels at exporting.

THE IMPORT SIDE of the trade deficit will remain a tough problem, although perhaps not as intractable as in recent years. That's because U.S. demand shows signs of cooling from its superheated growth rate of the past year and a half to a more sustainable pace. U.S. imports rose a slim 0.4% in April and May. Compare that with monthly gains averaging 1.8% during the previous six months.

Slower import growth coincides with the easing of overall consumer spending in the second quarter, perhaps to the slowest pace in more than a year. That was evident in the June data on retail sales, which fell 1.1% from May (chart). Imports of consumer goods, not including autos, plunged 3% in May, the largest monthly decline in more than a year and a half.

But the trend of overall import growth is likely faster than the latest data suggest. The May weakness in imports of consumer goods reflected two large, quirky-looking drops that will not be repeated in June: One in artwork, the other in pharmaceuticals. Plus, imports capital goods grew a slim 0.2% in May, even though businesses continue to ramp up outlays for equipme

As for the dollar, its decline will help to slow im somewhat. Already, the dollar's drop against the eu and the yen has lifted the prices of goods from Eur and Japan. But the weaker greenback h done little to stem t tide of imports from Asia. Goods from C for example, have s accounting for 21% the growth in U.S. imports during the year. At the same ti Asia's NICs have swallowed the curr shifts in order to gu market share. Prices their imports are down 0.7% from a year ago.

LESS OOMPH FROM CONSUMERS

Data: Commerce Dept., Global Insight Inc.

Nevertheless, as U.S. demand settles down to a m sustainable clip in the coming year, import growth a will slow. Even the rapid pace of imports from China cool off a bit, whether Beijing revalues its currency upward or not. Add in the improving outlook for exp and chances are very good that the trade deficit will a least stabilize in the coming year. It might even edge down a smidgen, adding to—instead of cutting from U.S. economic growth. ■

GREECE

A Gold-Medal Boost for Growth

THE GREEK ECONOMY has surged at an average yearly clip of 4.2% since 2000, when preparations for this summer's Olympics began in earnest. By Aug. 13, when the torch is carried into Athens' futuristic Olympic Stadium, up to $10 billion of Games-related spending will have been added to the $183 billion economy, one of the euro zone's smallest.

The extra cash has lifted real gross domestic product by at least 1% a year, economists reckon, enabling Greece to grow faster than the euro zone as a whole.

The good thing, says Lloyd Barton, a European economist at Pricewaterhouse-Coopers in London, is that the benefits could last long after the torch is extinguished.

AN IMPRESSIVE RUNUP TO THE OLYMPICS

Data: Greek Statistical Service, Organization for Economic Cooperation & Development

To be sure, the OECD projects growth will slow to 3.6% next year. That's partly because all the Games-related investment will end. But it's also because the government will have to cut spending to shrink the budget deficit—which has been driven above the euro zone's mandated limit of 3% of gross domestic product by higher-than-expected Olympics costs.

But after 2005 the economy should regain its momentum, thanks to the Games' positive legacy. For example, the hefty investment in Athens' transit system will boost productivity for many years. And, assuming the Games are a success, economists say they will give a boost to Greek national pride, spurring consumer and business spending. "The psychological impact—Greeks fe they are among the most advanc countries—should not be underestimated," says Paul Mylo chief economist at National Bank Greece. Greeks may become mor willing to accept badly needed reforms, such as more transparen in government and business.

Meanwhile, the balance of payments should improve after b Games-fueled capital goods impo stop. A successful Olympics coul attract up to 450,000 more touris year until at least 2011, predict tr experts. That alone would add so $1.1 billion a year, or 0.6%, to GD

Of course, if the Olympics are l by a terrorist attack, tourists coul desert the country. But short of th event, Greece could benefit from t Games—and outperform the rest the euro zone—for years. ■

–By David Fairlamb in Fran

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COMMENTARY

BY MIKE FRANCE

The New Accountability

In a post-Enron world, "I didn't know" won't cut it. But can CEOs meld caution with vision?

WHEN COMPANIES break the law, the first thing chief executives typically do is plead ignorance and blame everything on rogue underlings. In recent months investors have been treated to a parade of indicted former CEOs—from WorldCom's Bernard Ebbers to HealthSouth's Richard Scrushy—claiming such a defense. But few have been quite as aggressive at it as ex-Enron CEO Kenneth L. Lay. A few days after his criminal indictment on July 7, Lay offered up the perfect illustration of the deaf, dumb, and blind defense: "I cannot take responsibility for criminal conduct that I was not aware of," he told CNN's Larry King. "Enron was a company with about 30,000 employees in about 30 different countries."

Lay's defense may ultimately be successful. It is still unclear how much he knew about the company's financial deceptions. But his indictment raises a fundamental question of corporate governance: Just what should a CEO be expected to know about the basic operations of his company? After all, the alleged fraud at Enron was hardly something buried under five layers of bureaucracy. It was allegedly masterminded by Lay's two top tenants and provided the very basis of Enron's profitability. W no one exec can be expected to know everything that goes o a multinational, it is hardly a stretch to argue that a CEO pocketed hundreds of millions for running a company sh bear some responsibility for knowing where its profits come f and that those profits have been earned legitimately.

The combination of Lay's indictment and the convictio Adelphia Communications Corp. CEO John Rigas on 18 coun fraud on July 8 should serve to warn Corporate America tha old excuses won't fly anymore. Judges, juries, prosecutors, r lators, and shareholders are holding CEOs to higher standards noring red flags, accepting suspect or overly upbeat advice, turning a blind eye to questionable practices as long as the p its keep rolling in are no longer acceptable forms of managem

Unrealistic Burdens?

UNLIKE LAY AND RIGAS, the new generation of CEOs n personally vouch for their companies' financial statements. der the Sarbanes-Oxley Act, inspired by the meltdowns at ron and elsewhere, any reporting errors may be punishabl imprisonment. CEOs "are not being asked to guarantee t company's performance, but they are being pushed close that role," says University of Texas School of Law securities fessor Henry T.C. Hu. "That's why they make the big buck

SO IN THIS SECTION:

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36 The battle over stem-cell research

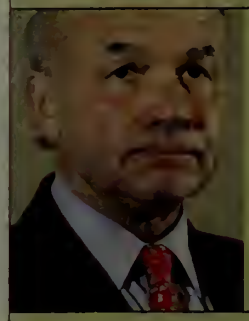
40 Software earnings are way off the mark

you are laying claim to the successes of your company, why not pick up the downside?"

Coming after an era of unprecedented financial scandal, the new executive accountability has plenty of populist appeal. But not every CEO is going to confront such seemingly clear evidence of wrongdoing. In fact, many experts question whether the new climate is placing unrealistic burdens on corporate leaders. Sometimes CEOs really don't know when bad things are happening. Other times they have no choice but to rely upon the specialized expertise of, say, tax lawyers, geologists, or engineers. "CEOs are visionaries and strategists. They are not supposed to get into the level of detail [Sarbanes-Oxley] requires," says Thomas V. Sjoblom, a Washington litigator who has challenged the constitutionality of the 2002 law on behalf of criminally indicted ex-HealthSouth CEO Scrushy.

The legal boundaries of this new world are still unclear. But chief executives are already changing the way they do their jobs. Forced to delve into the details of potential scandals, they're spending more time than ever watching PowerPoint slides about tax shelters, hedging strategies, and arcane accounting issues. "I sometimes complain that it's a pain," says Thomas J. Corcoran Jr., CEO of FelCor Lodging Trust Inc, based in Irving, Tex. "Is some of it stuff that I'd rather not be doing? Yes. But at the same time, I think it's really good."

DON'T BLAME ME, I JUST RUN THE JOINT



"Enron was an enormous corporation. Could I have known everything going on everywhere in the company?"

Ken Lay, former Enron chairman and CEO

"You have to rely, you have to trust people. You have to believe. You have to delegate.... I signed off on the information based on what was provided to me. And what I was told."

Richard Scrushy, ex-HealthSouth chairman and CEO

"Bernie Ebbers did not know about the accounting decisions of Scott Sullivan to reassign billions of dollars."

Reid Weingarten, attorney for former WorldCom CEO Bernard Ebbers

"John Rigas had a right to trust and rely on professionals and his own staff to get the financials right."

Peter Fleming, attorney for ex-Adelphia chairman John Rigas

Criminal Stupidity

THE QUESTION IS WHETHER the increased vigilance comes at the expense of long-term strategic planning. At Allstate Corp., CEO Edward M. Liddy says that he has to work harder than ever to meet his commitments. "I do worry that there's a little more focus on the internal control environment and the short term and perhaps less of a focus on the long term," he says.

Are Corporate America's leaders drowning in unnecessary details? It's too early to tell. But it isn't too soon to declare one casualty of the new legal climate: the figurehead CEO, the corporate celebrity who leads charities, hobnobs with politicians, and delegates the minutiae to somebody else. Lay exemplified this type of manager. W Jeffrey K. Skilling ran company, Lay circled globe in corporate jets lobbied in Washington f ergy deregulation.

In the old days, su manager would have largely immune from p cution. Why? Because p cutors have to prove white collar criminals gaged in intentional w doing. If a jet-setting genuinely doesn't know the CFO is cooking the b then he or she isn't like wind up in jail. There i such thing as criminal st ity. Or criminal oblivious

While these rules ha changed, the enforcemen vironment has grown tou Regulators are more willi bring legally and fact challenging cases. Con the aggressive prosecuti Martha Stewart. Or the that the Enron Task found a creative way to i Lay even though it could directly link him with schemes that happened w Skilling ran the show. whole liability climate is d ent," says St. John's Unive School of Law securities fessor Michael A. Perino.

Another big change is banes-Oxley, which will a to future corporate defend even though it was passe late to use against Lay, Ri or Ebbers. The law does modify the fundamental quirement that corpo chieftains have to engag conscious wrongdoing. B increases the likelihood CEOs will get wind of illegal shenanigans, since they are requ to ensure that their companies establish new reporting me nisms designed to reveal any legal violations. This more rol information flow undercuts the ability of the boss to clai didn't know what was going on.

The core issue for the current crop of CEOs is what will h pen when a company files a 10-K with materially inaccu numbers. While the legislators who drafted Sarbanes-Oxley not intend to hold CEOs accountable for every misdeed in t organizations, they clearly wanted top execs to face increa prospects of jail time. Several months after the act was pas Senator Joseph R. Biden (D-Del.) read a detailed analysis o creators' intent into the *Congressional Record*. "If lower-l corporate officials conspire to hide the true financial healt the company from the CEO for whatever reasons, the CEO

be held liable," Biden declared. And yet, he noted, "con- is avoidance of certain facts should not provide immunity prosecution." Biden's guidance will certainly be studied ly by the courts.

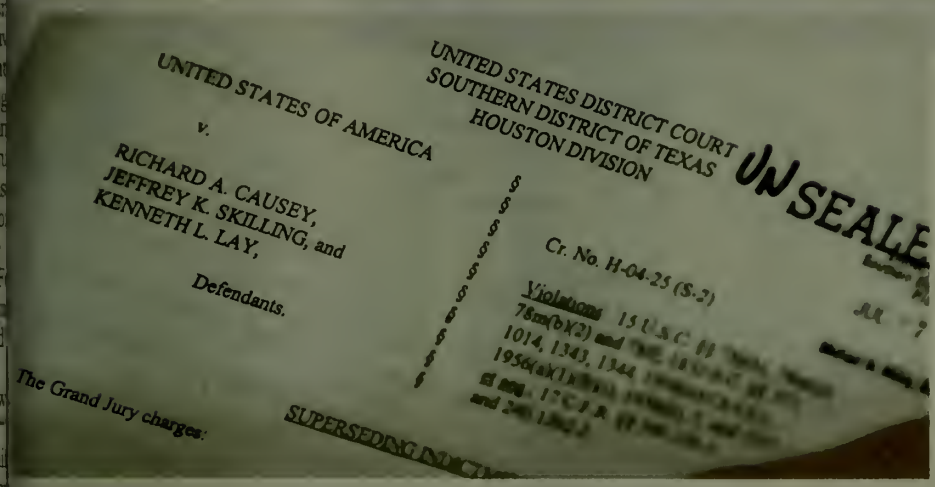
inted Advice

ESPONSE TO THE NEW THREAT of jail time, many CEOs tried to offload some of their Sarbanes-Oxley responsibil- ne approach is "roll-up" certifications, in which lower-lev- anagers are required to issue subcertifications for every ac- ting and legal issue that could generate criminal liability. this strategy help CEOs avoid prosecution? "No one will v until it's tested in [court], which is inevitable," says Uni- ty of Delaware governance expert Charles M. Elson.

similar air of uncertainty surrounds another key CEO defense: that he or she relied on the advice of professionals. Although Sarbanes-Oxley did nothing to puncture this alibi, courts have interpreted it far more narrowly in recent years. In Rigas' case, the fact that outside lawyers and accountants approved of some of his company borrowings didn't protect him. "If somebody from a law firm or accounting firm is telling you something that is too good to be true, then CEOs are not going to be able to rely on it anymore," says Hu of the University of Texas.

This is, in many ways, a brave new era for America's CEOs. Professionals can no longer automatically sanitize everything they do. Nor can they barricade themselves behind a wall of ignorance. If CEOs want to earn the big bucks, they're going to have to put their necks on the line. ■

–With Louis Lavelle in New York, Joseph Weber in Chicago, and Stephanie Anderson Forest in Dallas



CURITIES LAW

HE SEC TO TOP EXECS: EAD THE FINE PRINT

s suit against Lay says trades or loans on mpany stock can be insider trading, too

N 2001, ENRON CORP. was quietly lurching from crisis to crisis. Whatever he did or didn't know about Enron's woes at the time, Kenneth L. Lay rarely missed an opportunity to talk up the oil-and-gas trading concern with analysts Enron employees. The ex-chairman CEO even urged workers to follow his and buy stock. From August through ber, 2001, Lay bought $4 million h of Enron shares—which he cites as proof that he had faith in the company.

But there's a hitch. Privately, Lay was dumping far more stock than he publicly acquired, according to criminal and civil charges filed against him on July 8. In the same three months, he sold $26 million of Enron shares. Altogether in 2001 he unloaded Enron stock for $90 million. But because those shares were sold back to Enron, Lay did not have to disclose the sales until 2002, thanks to a loophole—since closed—in Securities & Exchange Commission rules.

INDICTED The SEC suit could undercut Lay's criminal defense

The difference between Lay's public statements and private actions is the foundation of the SEC's civil charges—one of the more aggressive interpretations of insider-trading law in decades. Opening a new chapter in the SEC's pursuit of alleged corporate crooks, the agency, in effect, is putting all CEOs on warning: They now face the risk of violating insider-trading laws when they trade company stock or borrow against it.

For Lay, the civil suit may be more serious than it first appears. The SEC complaint could undermine his defense against his criminal indictment on charges of conspiring to defraud investors by portraying the company as financially sound despite knowing otherwise. Why? The SEC lays out a trading pattern in which Lay appears to be an eager seller of Enron shares, contrary to his public statements. Lay insists he did nothing wrong and has pleaded not guilty to all the government charges.

"STAGGERING" STOCK SALES

SO HOW DID LAY cash out while appearing to support the stock? In 2001, according to the suit, he borrowed a total of $77.5 million from Enron, spread out over 20 transactions, and repaid the loans entirely with Enron shares. The repayments often came within a few days. Such stock sales vastly outweighed purchases. In seven transactions from August, 2001—when he resumed the CEO job after Jeffrey K. Skilling's surprise resignation—through October, 2001, he converted more than 918,000 shares into $26 million. "He was selling all the time," says Duke University law professor James

AT COURT Lay says he needed to sell stock to cover margin callls

D. Cox. "And the number of shares he sold is staggering."

Lay doesn't see it that way. In public he has said that he sold because he needed the funds. He had pledged his shares as collateral for some $100 million in personal loans from three commercial banks. When the value of his Enron stock declined, his bankers made margin calls or demands that he increase his collateral. In his trial, Lay is expected to claim that, with few other assets he could easily sell to satisfy those demands, he was forced to borrow from Enron, repay the Enron loans with stock, and use the proceeds to pay off the banks.

That argument appears to have warded off a criminal insider-trading count. Justice would have had to show beyond a reasonable doubt that Lay possessed important information the market lacked and that he intentionally traded to take advantage of that information. The SEC's burden of proof is lower. It need only show that the preponderance of evidence points to insider trading. The SEC complaint argues that Lay's trades reveal an effort to pump up the shares, dump his stock, and skirt disclosure rules that might tip off investors.

Under then-SEC rules, sales of stock back to the company did not have to be reported until 45 days after the close of the calendar year in which the trades occurred. So when Lay urged Enron employees to buy on Sept. 26, 2001, he knew there would be no record of his sales. SEC filings showed only that he had bought that $4 million worth of stock.

The SEC case, however, is equally significant for the new liabilities it could create for other execs. Agency officials believe it's relatively common for managers to try to have their cash and keep their shares, too, by borrowing against their stock. Doing so allows them to avoid sending bearish signals to investors while still monetizing their shares. The Lay case seems to show that the SEC views the practice as deceptive. "I think the SEC clearly is saying that you're going to have to disclose if you're borrowing against your stock because, in effect, that's a sale," says UCLA law professor Stephen M. Bainbridge.

The agency also is warning that execs may be setting themselves a trap if they use shares as collateral. Monetizing shares via loans could create a motive to pump up the stock and, as with Lay, subject execs to insider-trading charges if they later sell because of margin calls, says Cox.

The SEC is also resurrecting long-forgotten doctrines to remind insiders of their obligations. Indeed, says Cox, not since 1968 has the agency brought insider-trading charges against a corporate exec for trading in the company's securities while holding

THE STAT

$90 MILLION

Value of undisclosed shares Kenneth Lay sold privately to Enron in 2001 while making public statements in support of the stock

Data: Securities & Exchange Commission

back crucial informatio
the SEC appears to be
off an old legal princip
says officials can't tell
truths. That is, they can't
to be a buyer—even if
technically true—if they'
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At the same time, the
making it harder to
against inside-trading c
Like Lay, many execs ha
called program-trading
which telegraph stock-
intentions in advance. SE
state that such plans, i
with the agency, protect a
insider-trading charges
had two such plans that l
sell up to 2,000 shares a d
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2001, just as he was ste
down as CEO, so that he
diversify his assets. The S
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when an insider has important in
tion not available to the market. Unti
the agency has never brought a suit
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HEADS UP, TECH EXECS

A COMBINATION OF SEC rules ar
Sarbanes-Oxley Act of 2002 closed
of the loopholes that allowed Lay to
full disclosure. Companies can no l
lend money to officers and directors
new SEC rules require insiders to r
stock sales back to the issuer withi
days. But no law or regulation pre
higher-ups from taking out bank loa
cured by shares of company stock.

Already, the SEC is investigatin
merous cases of tech executives'
another common ploy to avoid ti
off investors about stock sales. Whe
tech bubble was driving up share p
in the late '90s, many officials use
phisticated options contracts to ca
their shares while putting off delive
the shares for several years. The
ferred capital-gains taxes—and av
sending a sell signal. Now the S
making it clear that such transac
are the same as selling—and ins
who avoided disclosing them cou
subject to an SEC enforcement actio

The Ken Lay criminal indictmen
overshadowed the parallel SEC civil
suit. But corporate insiders and the
torneys would be wise to give the
complaint a close read. ■

–By Paula Dwyer in Washi

MPLOYMENT

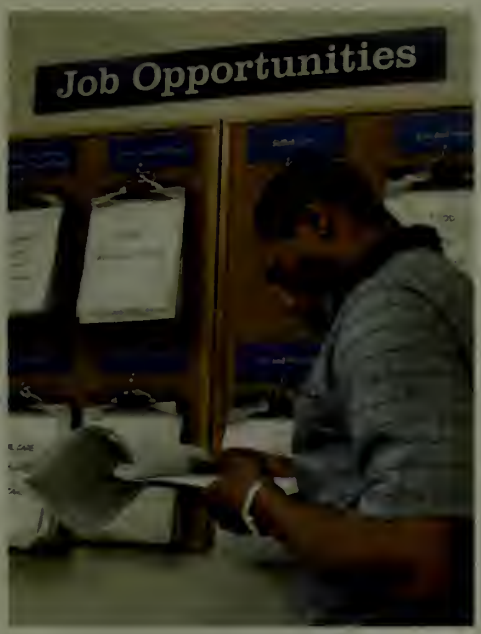
NOTHER LOOK AT HOSE JOB NUMBERS

he Bureau of Labor Statistics says more the recent new ones were high-paying

SURE, AMERICA IS ONCE again creating jobs. But are most of them of the burger-flipping variety, with below-average pay? Many economists are concluding just that. "Ameri- Job-Quality Trap" is the headline on ecent research report by Morgan ley Chief Economist Stephen S. ch. "Are the New Jobs Good Jobs or w Jobs?" asks another study, this one Merrill Lynch & Co. Job quality is also rging as an issue in the Presidential . On July 13, the campaign of Demo- ic contender Senator John Kerry ar- d that 90% of the jobs created during Bush administration have been in -wage industries.

ut new evidence shows that the pes- ists may not have a case. According to prepared by the Bureau of Labor Sta- cs, which have not been widely dis- uted, growth in high-wage jobs has ally been quite healthy. The figures w that the U.S. economy created e high-paying jobs than low-paying in the year that ended in June. That's ign that the economy is better for kers than commonly believed. It also ld be good news for the Bush-Cheney paign, which played up the numbers nswering Kerry's attack.

Why have many economists drawn h gloomy conclusions? It's largely be- se they've focused on employment nges by industry. Looked at that way, signs are troubling, since job growth been stronger in low-paying industries like retail than in high-paying industries like financial services. But even low-paying sectors boast some high-paying jobs—and if more of those jobs are being added, overall pay growth can be healthy.



That appears to be exactly what has happened, according to the new data from the non-partisan BLS. The bureau divides up all workers into 11 occupations, ranging from management to production. At the same time, it assigns every job to one of 14 industries, meaning that the U.S. workforce can be sliced into a total of 154 occupation/industry groups, such as "management occupations in the leisure and hotel industry."

In response to a request about a month ago from the White House Office of Management & Budget, BLS supplied the median 2003 weekly wages and salaries for workers in each of the 154 groups. The median manager in manufacturing makes $1,125 a week, for example, vs. just $649 for the median manager in agriculture. The BLS has since provided the numbers—without analysis—to other agencies and some outside organizations and news media, including *BusinessWeek*.

FINER FOCUS

THE NEW DATA make it possible to see pay trends within the workforce with unprecedented accuracy. According to *BusinessWeek*'s analysis, 48% of American workers belong to occupation/industry groups where the median pay is $559 a week or more. Yet employment growth in those higher-paying groups accounted for well over half of total job growth during the past year. Average monthly employment in the higher-paying groups was 744,000 higher in the 12 months ended in June, 2004, than in the previous 12-month period. By contrast, only 408,000 jobs were added in groups whose median pay was $553 a week or less, even though they account for 52% of total jobs. (No groups have median pay between $553 and $559 a week.)

HELP WANTED
The data could be good news for Bush

The gains in job quality come from a variety of sources. For instance, above-average growth occurred in professional occupations in wholesale trade, with median weekly pay of $908, as well as in production occupations in mining, at $665 a week.

Jobs pessimists note that inflation-adjusted pay has fallen in recent months. But that's because of an uptick in inflation, not a deterioration of job quality. Also, Morgan Stanley's Roach and others have pointed out that part-time jobs account for the bulk of all jobs created since February. Still, the overall share of part-time jobs is no higher than during the late-1990s boom, at around 18%. And most people take part-time jobs because they prefer them. Only 3.2% of jobholders were working part-time last month for what they called economic reasons.

Are there problems with the economy? Sure. But based on the new BLS data, it's hard to argue that job quality is one of them. ■

–By Peter Coy in New York

Where the Jobs Are

sed on median pay for U.S. workers, ked by occupation/industry group, of 59 a week

408,000
Lower-Paying Jobs Created July '03-June '04*

744,000
Higher-Paying Jobs Created July '03-June '04*

* Change in 12-month average from previous 12 months. **Data:** Bureau of Labor Statistics

COMMENTARY

BY ARLENE WEINTRAUB

The Stem-Cell Flap: Simmer Down

Washington should lift the research ban. But Kerry and others are overzealo

IT LOOKED LIKE a shrewd move when organizers of the Democratic National Convention announced on July 12 that they had added Ronald Reagan Jr. to their roster of speakers. The son of the Republican President—who died on June 6 of complications from Alzheimer's—has long criticized President George W. Bush's policy of limiting federal funding for embryonic stem-cell research. Democratic candidate John Kerry has repeatedly vowed to restore the funding if he's elected, saying he thinks the cells could cure 100 million sick Americans, including Alzheimer's patients.

Kerry and other stem-cell advocates need to simmer down. It is true these cells—which can grow into any tissue in the body—have shown promise for treating some diseases. Washington must lift the funding ban if researchers are to unlock their full potential. But advocates are overstating stem cells' near-term ability to treat grave illnesses. In doing so, they not only distort the science; the hopes they raise among many people who are sick today are also sure to be dashed.

If researchers studying stem cells were freed from politics and amply funded, how would the world of medicine change? For some complex diseases—including Alzheimer's—there would be little impact. While such cells might indeed be used to repair some forms of brain damage, Alzheimer's doesn't just destroy isolated cells. Vast networks of intricate neural connections—the very backbone of complex memories and mental skills—die off in a process that still confounds scientists. Even if researchers could coax stem cells to repair all the pieces of the brain's broken circuitry, the new cells would be annihilated just like other brain cells. Untangling this problem could take decades of research. Even Reagan Jr. admits it may be a pipe dream. "Alzheimer's is a disease, ironically, that probably won't be amenable to treatment through stem-cell therapies," he conceded in an intervi MSNBC, where he works as a political commentator.

REAGAN A longtime critic of President Bush

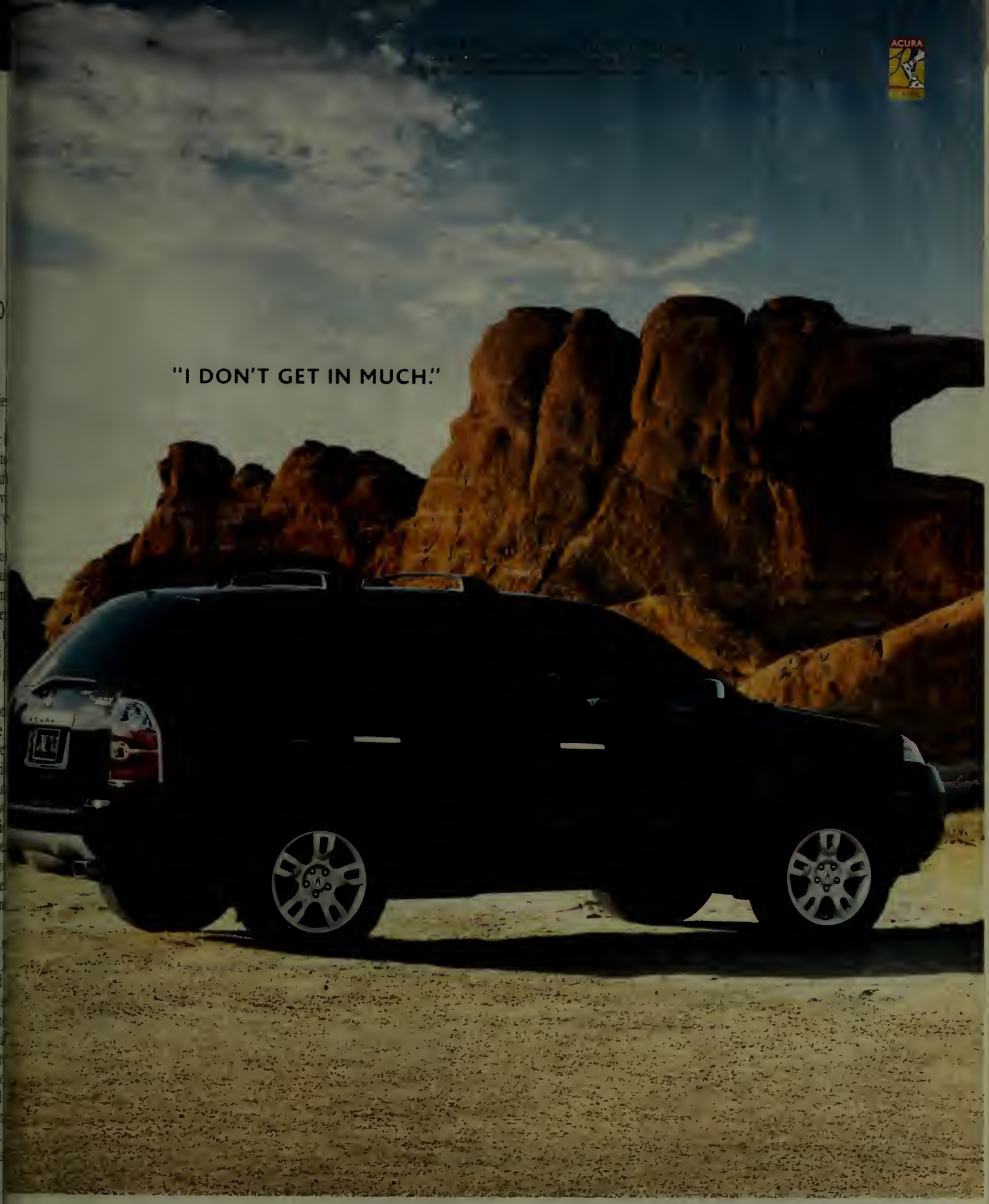
The picture is brighter beyond Alzheimer's and other understood ailments. By studying how these cells generat ious tissues and organs, scientists may be able to identi cascade of genetic signals that lead to normal human dev ment. That will help them understand what's happening a healthy body goes haywire.

In a few disease areas, embryonic stem cells offer hope f ly novel therapies, and maybe even cures. Take diabetes—a er complex disease, but one whose central switch has bee described. The most serious form of the illness occurs whe body doesn't produce enough insulin, the hormone that lates blood sugar. Over the past few years, researchers coaxed embryonic stem cells from mice to into insulin-producing cells.

Now scientists aim to turn human emb ic stem cells into tiny factories to generate less supplies of pancreatic cells, which then be transplanted into diabetes pat "There's no good alternative," says R Goldstein, chief scientific officer at the Juv Diabetes Research Foundation Internati Last year only about 400 donated pancr were available in the U.S. for patients wh quired transplants of insulin-producing c not nearly enough to serve the 1 millio tients who needed such cells.

Recent research suggests embryonic cells may be useful for other disorders. On 30, a group of Israeli scientists announce they had transformed human embryonic cells into neurons that produce dopamin vital brain chemical that's lacking in pat with Parkinson's disease. Then they t planted the cells into rats that had Parkins like symptoms, and the animals improved nificantly. Other studies have achieved si success in rodents with spinal cord injuries imal results, however, don't always tran into success stories in humans.

The pro-research camp is right to argue throttling stem-cell research in the U.S. at early stage will slow medical progress. B their haste to dismantle the ban and adv stem-cell treatments, the advocates must exaggerate the near-term benefits. Disto the facts will bring no benefits to the millio patients and families waiting for cures. ■



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PHARMACEUTICALS

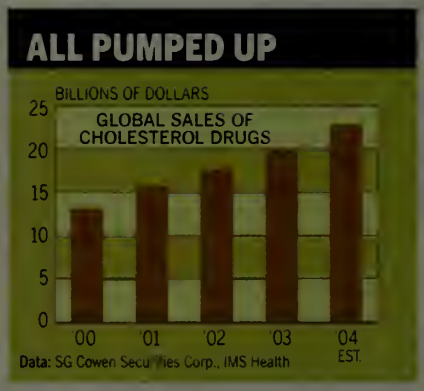
HOOKED ON THE CASH FROM CHOLESTEROL

Statins are massive moneyspinners. But can Big Pharma sidestep expiring patents?

THERE'S NO OVERSTATING the importance of cholesterol-lowering drugs to the pharmaceutical industry. They bring in $20 billion a year in sales, the single biggest market in the $492 billion global prescription-drug business. Sales are growing at a healthy 15% clip. And with the government releasing new recommendations on July 12 encouraging doctors to drop targets for LDL—or so-called bad cholesterol—even lower for patients at high risk for heart attacks, sales are likely to shoot ahead even faster.

But it won't all be Easy Street for drugmakers. The battle for share in the lucrative market is about to intensify. Merck & Co. and Schering-Plough Corp. are joining forces to win Food & Drug Administration approval for their new entrant, Vytorin, and analysts expect them to get the O.K. in late July.

The two drug giants plan to put big bucks behind an increasingly popular maneuver for drug companies struggling to extend aging franchises: combining two existing drugs into one pill. Vytorin is a blend of Merck's Zocor, one of the popular treatments known as statins, and another cholesterol-lowering product the two drug giants already co-market, Zetia. The two-drug combo, the companies say, will offer the most potent cholesterol-lowering therapy yet. And if Merck can switch a lot of Zocor patients to the new pill, which will be under patent protection through the middle of 2015, it will lessen the impact of generic Zocor competition in the U.S., which should hit in 2006.



THE WAR ON RIVALS' DRUGS

IT MAY BE A SMART strategy, but Merck and Schering-Plough face formidable competition from Pfizer Inc., which dominates the market with its $10 billion Lipitor, and AstraZeneca PLC, which is struggling to establish it statin, Crestor. Merck and Sch Plough are betting that the u mechanism of Vytorin will make i Statins such as Lipitor and Zoc cholesterol by blocking producti bad cholesterol in the liver. The component of Vytorin works i same fashion. But the pill also co Zetia, which prevents absorption o lesterol in the intestine. Hitting bo production and absorption of chole yields a greater reduction in LDL even the market leader Lipitor, sa Rick Veltri, group vice-presider worldwide clinical developme Schering-Plough Research Ins making Vytorin a sort of superstat

Rivals dispute that Vytorin has ar over their offerings. Greg Duncan, president for U.S. product marketi Pfizer, points out that while Lipito trials showing that it saves lives, th torin combination does not yet have data. He also that the pairing cor and Zetia d have the proven record that L does. "There i reason [for p cians] to be me around with competitors," Duncan.

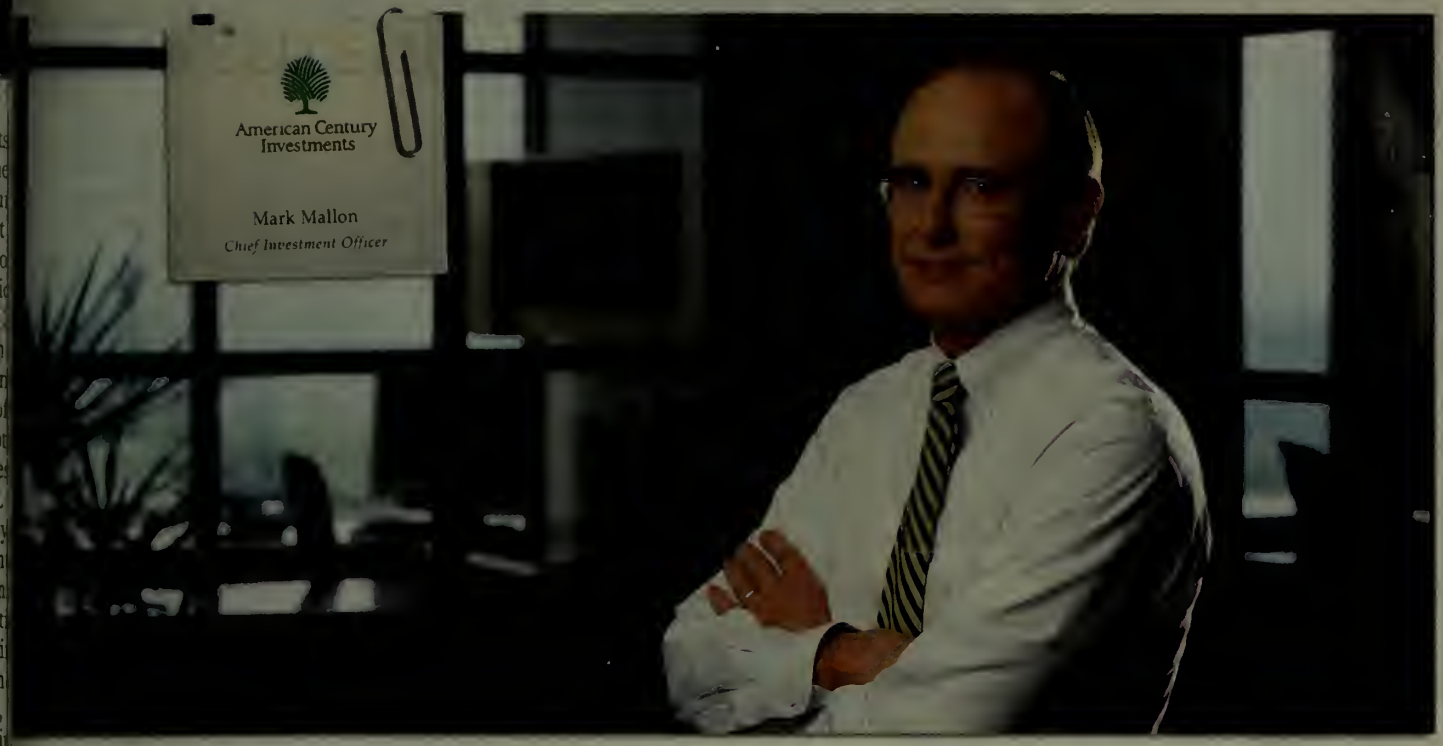
Certainly, M and Schering-Pl have a lot ridin Vytorin. Schering-Plough is expect post a loss this year and barely break next year as key franchises slide i face of mounting competition, inclu over-the-counter versions of its a medicine Claritin. And Merck swoon when its $5 billion Zocor U.S. patent protection.

Of course looming patent expirat are just what's vexing other drugma too. Market giant Lipitor could generic rivals as early as 2011. P hopes to avert disaster when that pens by developing a drug combi Lipitor with a compound that ra HDL, or good cholesterol. If that pro wins approval and Pfizer can sw large numbers of patients to the combo, the sting from Lipitor gen will be lessened.

It's all about preserving profit businesses. And, given the paucity of ly new drugs in their pipelines, phar ceutical companies have little choice to try every trick there is. ■

–By Amy Barrett in Philadel

THE TWO-IN-ONE GAMBIT Vytorin will combine Zocor and Zetia in one pill



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EXCEPTIONAL CEO Kagermann has diversified SAP's product lineup

HIGH TECH

SUDDENLY, A MUSHY SOFTWARE MARKET

Corporate buyers aren't buying. Some fear that spells trouble for other tech sectors

JUNE E. DREWRY TYPIFIES today's frugal tech buyer. Drewry, the chief information officer at AON Corp., must make sure the Chicago insurance brokerage has the software it needs to stay ahead of rivals. But she figures she can do the job just fine without hiking her software budget. Besides, she says, "there's nothing new out there that is the latest and greatest answer to your prayers."

Drewry's ambivalence goes a long way toward explaining the woes suddenly afflicting the $200 billion corporate software industry. This month, more than 20 companies, from Siebel Systems and Veritas Software to Computer Associates International, have stunned investors with warnings that second-quarter sales and earnings will fall far short of expectations. Only Germany's SAP, which reported a 15% hike in software license revenues, seems to have escaped the storm, thanks to its size and to CEO Henning Kagermann's strategy of diversifying its product lineup.

The bloodbath is prompting worries that the industry's brief, two-quarter rebound has already fizzled. Companies like Siebel Systems Inc. and PeopleSoft Inc. had started to benefit as companies started to boost spending for the first time since 2001. But just as quickly as many projects started up, they were shut down or delayed in the second quarter. Market researcher Gartner Inc., which once forecast 5% sales growth for 2004, now expects just 3%. Buyers cite a variety of reasons, ranging from rising costs to worries that the economy is losing steam. "We can always go slower on a project," says Dan Barth, chief information officer of Oklahoma Publishing Co. "It's nice for us, but unfortunate for [software makers]."

And it's not just software makers. Some are starting to fear the entire tech industry could be headed for an bust. After all, on July 13, industry wether Intel Corp. jangled nerves it said inventories grew 15% in th ond quarter after an 11% increase i quarter before. What's more, if co nies are buying less software, they ably don't need more PCs or server

But the corporate software mark problems that aren't likely to spread t er parts of tech. For starters, the indu overcrowded—something one can' for PC makers, which consolidated 1990s. There are still hundreds of sof outfits vying for corporate dollars. An porations that once bought from a lau list of suppliers are limiting their sper to a handful. "It's costly to support mu products," says Phil Zwieg, vice-pres of the Society for Information Mar ment. As a result, Gartner analysts as many as half of today's software co nies to disappear within two years. winners are likely to be big companies diverse software portfolios, including Microsoft, Oracle, and IBM. Proof is i numbers: Along with SAP, which is nering an ever bigger share of the soft pie, Oracle Corp. is reporting strong On July 14, it expressed optimism abou second half of the year, and said it exp revenues in its current fiscal quarter crease 6% to 9% from a year ago.

Perhaps the strongest sign that weakness will continue is the distur falloff in license revenues reported by eral companies. At PeopleSoft and Si they fell an estimated 9% and 16% spectively. License revenues are a indicator of both customer interest long-term prospects. Even when co nies are still spending, they're lookin cheaper options like open-source sold by few traditional software mak

Will corporate spending pick up ag "It's never going to be like it was," Jean Balgrosky, CIO at San Diego-b Scripps Health. That's good news handful of companies, but a sign for that Darwinian forces are about to sv the sector. ■

–By Jim Kerstetter in San Mateo, C with Roger O. Crockett in Chicago, Elgin in San Mateo, and Andrew

Falling Short

Only software giant SAP is growing briskly these days.

Estimated change in second-quarter software license revenues:

SIEBEL	PEOPLESOFT	BMC	VERITAS	SAP
–16%	–9%	0%	+4%	+15%

*Includes estimate of May and June, 2003 license revenue for J.D. Edwards, acquired by PeopleSoft

Data: Company

a for Business

Profiles in Business Mobility #2 | Versatility

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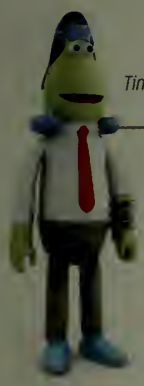
The Nokia 6820 Messaging Device


Time Zone Tim

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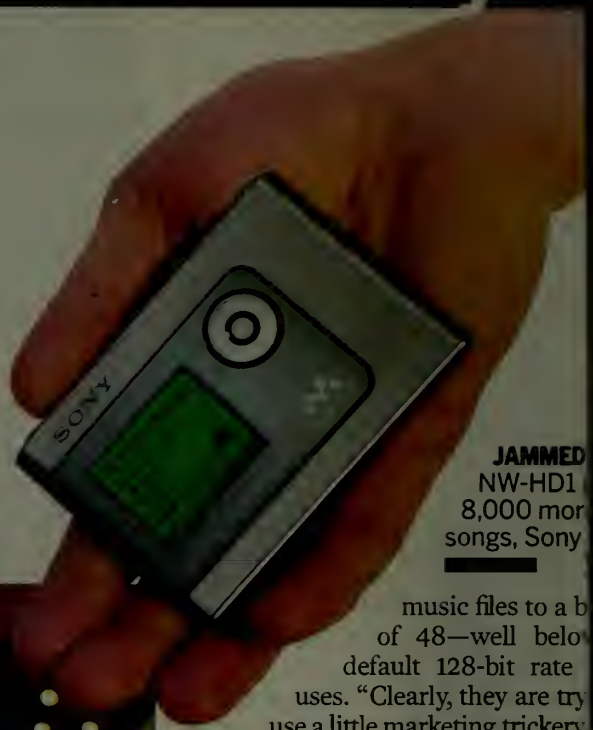
MARKETING

IN THIS CORNER, THE iPOD . . .

Sony's claims for its new Walkman have goaded Apple into a fight



JAMMED NW-HD1 8,000 mor songs, Sony

IN MID-AUGUST, SONY CORP. will roll out its answer to the iPod music player. The Japanese giant's NW-HD1 Network Walkman weighs in at less than four ounces, making it slightly smaller than Apple Computer Inc.'s popular iPod. More to the point, Sony claims that its 20-gigabyte Walkman can store 13,000 songs, compared with the 5,000-song capacity of a similarly equipped iPod.

Faster than you can say download, Apple was all over Sony's boast, saying that its rival was misleading consumers. Sure, Sony can cram 13,000 songs onto its player, said Apple, but only by reducing sound quality. Sony fired back, arguing that its superior technology allows it to give consumers more music at comparable quality to the iPod.

Welcome to the latest iteration of product one-upmanship. PC makers have been playing this game for years, marketing their boxes on the basis of gigahertz, or how quickly the microprocessor runs applications. Now that the computer industry is moving into consumer electronics—making and selling everything from music players to digital cameras—they are wooing (and confusing) consumers with a barrage of arcane statistics touting everything from battery life to music quality as measures of superior performance. In the coming months, as the music-player wars heat up, expect to hear a lot of marketing spin about compression and bit rates. "Everyone is trying to show their product is faster, bigger, better," says Omid Rahmat, U.S. general manager of independent reviewer Tom's Hardware.

"MARKETING TRICKERY"

HOW DO CONSUMERS wade through all of the hype? By understanding that compressed music is an issue of quantity vs. quality. Getting a lot of songs onto a player or a PC, or making them small enough to download fast, entails compressing digitized music files. The maker crunches them down by deleting redundant sounds as well as those that humans can't hear. The industry uses a standard compression measure called bit rate; the lower it is, the smaller the music file and the more you can squeeze onto a PC or music player. The downside of that, however, is that a lower bit rate generally means lower sound quality.

iPOD Apple says its higher bit rate yields higher-quality sound

That's the logic Apple used to attack Sony's new player. The creator of the iPod notes that to jam those 13,000 songs onto its player, Sony would have to compress music files to a b of 48—well belo default 128-bit rate uses. "Clearly, they are try use a little marketing trickery Apple Executive Vice-President W. Schiller. Moreover, Sony's defa rate for the new player will be 68. Bu says its compression technology is s or to Apple's and can maintain q even at lower bit rates. "Listen to it self," says Todd Schrader, a Sony Ele ics vice-president. "I don't have a g ear, but it sounds great."

For now it's impossible to verify claims, since experts have yet to co tests on its music player. In a decided scientific test, one *BusinessWeek* writ two friends listened to Frederic Ch Etudes Opus 10 and Opus 25, compr from a store-bought compact disc to bit rate using Sony's technology. The compared it with the original CD. what? They couldn't tell the differen

That prompts the real question: any of this really matter to the av music lover? Audiophiles insist that pressed music files in no way measu to CD clarity. And while it's true that ing up a PC or music player to the stereo might not deliver CD sound, of people are doing it anyway. Besi the sound quality of compressed was substandard, it's hard to see ho ple moved 860,000 iPods during its third quarter, a performance that h the company triple its profit to $61 m and boost revenues 30% to $2.01 bi

In the end, consumers will d whether they want quality or quanti it happens, they already have the cl Both Apple and Sony's music ma ment software allows users to cl from a range of bit rates. So chalk u Sony-Apple spat to old-fashioned hy

–By Cliff Edward in San Mateo,

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COMMENTARY

BY DAVID WELCH

GM: Enough with the Come-Ons

What the carmaker needs now is sizzling new models—not more discounts

WHEN GENERAL Motors Corp. launched 0% financing deals after the September 11 terrorist attacks, it did so to coax jittery buyers into dealerships again. But GM found another reason for pouring on the incentives: to steal U.S. market share from its struggling Motown rivals. For a while, the strategy worked. In 2001 and 2002, GM's market share grew at the expense of Ford Motor Co. and Chrysler Group.

Nearly three years into the price war, however, GM's gambit seems to be running out of gas. Just look at its lousy June sales numbers. Despite incentives averaging an industry high of $4,100 a vehicle, GM sales tumbled 15%, compared with Ford's 11% slide and Chrysler's 1% advance. The No. 1 auto maker's share has shrunk to 26.8% of the market, down from 28.1% at the end of 2001. GM's solution? Bigger discounts of up to $5,000 on many of its trucks—with some dealers throwing in an extra grand to boot. But all that discounting is hammering margins and profits per vehicle, which now are weaker than both Ford's and Chrysler's. "GM's in a tough spot," says Deutsche Bank analyst Rod Lache. "Things will get worse before they get better."

WEAK SALES A dealer pitch in Connecticut

The Detroit carmaker had bet that a bevy of new models this year would draw in buyers. But that hasn't happened so far. The new Chevy Malibu sedan has had only modest success, and the all-new Chevy Colorado pickup is piling up on dealer lots. While three new vehicles in coming months could do better, for now the weak showing has kept GM from easing off the pricey deals.

By contrast, Ford and Chrysler have some bona fide hits that sell with only minimal incentives. Chrysler's 300 sedan and Dodge Durango sport-utility vehicle are both flying off the lots. And even where they do have to cough up cash, GM's rivals have managed to limit damage from the price war. While GM tends to offer equal deals on nearly all models, for example, Ford tries to use incentives on thinly profitable models like the Ford Focus; serves bigger giveaways for its most profitable models. "N blinked," says Ford Chief Operating Officer James J. Padi

Thanks in part to those new models, Chrysler's shar inched up, from 13.2% to 13.5%, since the price war began new F-150 has helped Ford outsell GM in full-size pic While Ford's share has fallen from 21.9% to 18.8%, it has b ed profitability. GM is losing ground on both fronts.

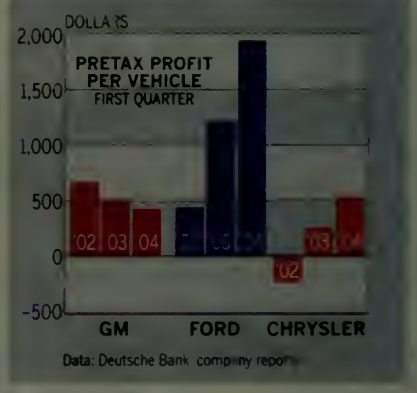
Indeed, the one-two punch of hit models and selective counting have allowed Ford and Chrysler to pull ahead o in the crucial measure of profit per vehicle. GM now earn $436 per vehicle, a 50% drop since 2001. Chrysler gets $ two years ago it was losing money on its cars. But No. 2 has really moved to the head of the class: In two years, p have soared fourfold, to nearly $1,900 per car. Sharp cost ting in the first quarter as well as a better product mix helped. Ford not only pared low-profit sales to car rental f but also gets 70% of its sales profitable trucks, vs. GM's 60%

Given its shrinking share, may have little choice but t back sharply on production. analyst Robert Hinchliffe estim that even if industry sales pick the second half, GM may nee trim production by up to 17 meet its goal of slashing invent by 200,000 vehicles. And would mean another blow to p its, since furloughed auto wor still must be paid. To prepare the worst, GM aims to dramati cut costs by yearend.

That would help, but what really needs are new hits. Later year, it will start selling the sha styled G6 midsize. The new Co will compete with pricey small such as the Volkswagen Golf Honda Civic. And next year, m of the cars designed under guidance of hit maker and V Chairman Robert A. Lutz will ar in showrooms. They had be sell. Otherwise, GM will be stuc Incentives Road. ■

–With Kathleen Kerwin in De

GM'S SLIPPERY ROAD



Data: Deutsche Bank company reports

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scuss your general health status with your doctor to ensure that you are healthy enough to engage in sexual activity. If u experience chest pain, nausea, or any other discomforts during sex or an erection that lasts longer than 4 hours, seek mediate medical help. The most common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less mmonly, bluish vision, blurred vision, or sensitivity to light may briefly occur.

ease see patient summary of information for VIAGRA (25-*mg*, 50-*mg*, 100-*mg*) *tablets on the following page.*

PATIENT SUMMARY OF INFORMATION ABOUT

VIAGRA®
(sildenafil citrate) tablets

This summary contains important information about VIAGRA®. It is not meant to take the place of your doctor's instructions. Read this information carefully before you start taking VIAGRA. Ask your doctor or pharmacist if you do not understand any of this information or if you want to know more about VIAGRA.

This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

What Is VIAGRA?

VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated).

You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

How Sex Affects the Body

When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

How VIAGRA Works

VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

VIAGRA Is Not for Everyone

As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates–either regularly or as needed–you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

What VIAGRA Does Not Do

- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV–the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

What To Tell Your Doctor Before You Begin VIAGRA

Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, heart attack or narrowing of the aortic valve)
- have ever had a stroke
- have low or high blood pressure
- have a rare inherited eye disease called retinitis pigmentosa
- have ever had any kidney problems
- have ever had any liver problems
- have ever had any blood problems, including sickle cell anemia or leukemia
- are allergic to sildenafil or any of the other ingredients of VIAGRA tablets
- have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- have stomach ulcers or any types of bleeding problems
- are taking any other medicines

VIAGRA and Other Medicines

Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies.

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking alpha-blocker therapy for the treatment of high blood pressure or prostate problems, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as you take your dose of alpha-blocker.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*.)
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

Finding the Right Dose for You

VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA. If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period. If you are taking alpha-blocker therapy, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as your dose of alpha-blocker.

How To Take VIAGRA

Take VIAGRA about one hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

Possible Side Effects

Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

Accidental Overdose

In case of accidental overdose, call your doctor right away.

Storing VIAGRA

Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

For More Information on VIAGRA

VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com or call 1-888-4VIAGRA.

23-5515-00-6
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TED BY MONICA ROMAN

ADLINER

REG
ENNEMAN

HOPPER OF CHALLENGE

another change in the cutive suite finally fire up ger King? On July 13, the -food chain named Greg nneman as its new CEO. 42-year-old head of Works, a Houston private ity firm, has a big order to Revenues at Burger King e declined for five years in w. Suffering from years of porate neglect, many chisees are losing money, Wendy's International is sed to become the nation's ond-largest burger flipper, ind McDonald's. Brenneman is known for narounds. He helped ntinental Airlines return to fitability in the 1990s and earheaded the sale of cewaterhouseCoopers nsulting to IBM in 2002. To Burger King's 11,220 res, Brenneman is looking onger hours and a broader nu. Although he has cked off on plans by prior nagement to close ndreds of stores, he'll p in place a financial tructuring program for nchisees. Their support is sential to any turnaround.

–*Brian Grow*

CSFB: MORE SWITCHEROOS

The executive reshuffle at **Credit Suisse First Boston** continues. Since **Credit Suisse Group** Co-CEO John Mack was abruptly ousted on June 24, investment bank CSFB has suffered from three high-level resignations. But on July 14, when CSFB's new CEO Brady Dougan announced his new team, it was clear that some key folks are still on board. Rainmaker Brian Finn will remain, as president. So will general counsel Gary Lynch. The group's chief risk officer, Richard Thornburgh, will become CSFB's vice-chairman, and Neil Moskowitz is the firm's new chief financial officer. The big question now hangs over Chairman Stephen Volk: His name isn't on Dougan's list, and insiders say he hasn't decided if he'll stay.

BARGAINS IN THE SKY

To the delight of consumers and the dismay of airline investors, **JetBlue Airways** joined other discount carriers on July 13 by announcing a sweeping fare sale. The scrappy New York carrier is cutting fares up to 50% for fall travel, with some one-way prices as low as $49 from New York to Florida. The sale—combined with others from such low-cost players as **Southwest** and **AirTran**—is expected to squeeze profits for the entire industry but will likely hurt the money-losing majors the most. Thanks to the earlier-than-usual sales, which major carriers have matched, **Bestfares.com** CEO Tom Parsons figures passengers can fly between more than 351 city-pairs for under $99 roundtrip.

DIALING FOR MCI?

Perhaps **MCI** CEO Michael Capellas should watch out for his job. The telecom giant issued a press release on July 12 saying New York-based investment company **Leucadia National** was seeking approval from antitrust regulators to acquire control of MCI. Leucadia, which hasn't actually made a bid, declined to comment on the matter. But Leucadia has hired hard-charging telecom veteran Joseph Nacchio as an adviser, people familiar with the matter say. The news was first reported by *The Wall Street Journal*. Nacchio, the former chief executive of **Qwest Communications International,** also was a senior executive at **AT&T.** Nacchio wasn't implicated in the accounting scandal at Qwest and is no doubt eager to return to the helm of a large public telecom company. Nacchio declined comment.

RED HAT'S NEW MATH

Red Hat may be an open-source company, but that doesn't mean its accounting is an open book. The Raleigh (N.C.) company's stock plunged 22.7% on July 13 after it announced it will restate its financial results for the past three years as a result of an accounting change. The shift in recognition of software subscriptions revenues has only a minor impact on past results, but the fact that the company didn't reveal the change along with its earnings announcement on June 17 has analysts and investors scratching their heads.

ET CETERA...

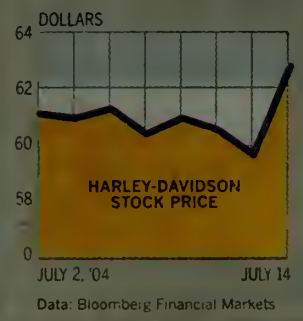
>> **McDonald's** said it expects second-quarter profits to exceed forecasts.

>> **YUM! Brands** reported a 45% gain in second-quarter earnings.

>> **Johnson & Johnson's** second-quarter profits beat Wall Street's expectations.

CLOSING BELL

Harley-Davidson is revving up again. The bikemaker's stock climbed 5.6% on July 14, to $62.95, on news of an 18.8% rise in U.S. retail sales in the second quarter. No wonder Wall Street has left its earlier dismay with Harley's modest sales targets in the dust.



(L TO R) BLOOMBERG NEWS; RICHARD SHEINWALD/ BLOOMBERG NEWS; CHART BY RAY VELLA/BW

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TED BY RICHARD S. DUNHAM

Vhy the GOP Has Medicare Headache

EAR AGO, REPUBLICAN POLLSTER Bill McInturff was ecstatic. A or Medicare drug bill was headed for approval in Congress. l McInturff, along with most analysts, viewed its passage as ıge political plus for President George W. Bush and the GOP. r four decades, he saw the ballyhooed drug benefit as a sformational" moment that would Republicans shake the "Mediscare" boo—that perennial Democratic ı that they were out to wreck the pop- health program for the elderly.

ıt the political earth never moved—at not the way Bush and the GOP ex- d. Eight months after the President d the $400 billion-plus drug law and han four months before Election Day, ıeasure is a bust on the hustings. Even ew drug discount card, a money saver ıany seniors, has left voters cold. "We benefits to millions who didn't have ," says McInturff. But, he adds, "that le message got lost."

hat we have here, it s, is a monumental Re- can failure to communi- According to an Apr. 1-5 er Family Foundation 39% of those surveyed an unfavorable view of ıew Medicare law, while viewed it positively. And early 2 to 1, seniors had a tive impression of the ram. That's bad news for , since GOP strategists ve seniors—especially ly white women—are vi- his reelection chances. om line: a huge advan- to Democratic Presiden- hopeful John Kerry. By 52% to 32%, voters believe Kerry would do a better making prescription drugs affordable Bush, according to a June 20-23 sur- y the bipartisan Battleground Poll.

hat went wrong? First, the law is hard nderstand. The complex discount card for only 18 months. Beginning in 5, it will be replaced by a drug insur- program. Other provisions provide rnment subsidies for insurers to offer new Medicare managed-care plans. "People simply do not have this figured out," says Democratic pollster Geoffrey Garin.

ATTACK MODE Kennedy calls the Medicare law a Big Pharma boon

Grassroots Blitz

TO MAKE MATTERS worse for the GOP, Bush never took the kind of high-profile victory lap that usually accompanies a big legislative win. Concentrating on the war in Iraq, he made few speeches promoting the law. And with many conservatives troubled by its high cost, he never enjoyed the partisan chorus of support he got on tax cuts.

That gave Democrats such as Senator Edward M. Kennedy (D-Mass.) an opening to blast the new law as a giveaway to drug companies and HMOs. And while Kerry has not proposed an alternative plan, he and other Bush critics are targeting a provision of the law that bars the government from negotiating for the lowest prices with drugmakers. A coalition of union and liberal groups called the Take Back Our Medicare Campaign is gearing up a grassroots blitz on the issue.

The GOP also hoped that AARP, the powerful seniors' lobby that endorsed the drug bill in 2003, would promote the law. Instead, under intense fire from its members, AARP has focused on the need to cut drug prices.

The battle isn't over, to be sure. Bush and his allies in the drug and insurance industries are likely to kick off an advertising counterattack come fall. And as more people learn about the drug card's benefits, some voters may be won over. But at least for now, the GOP finds itself in a familiar spot: playing defense against Democrats' Mediscare charges. ■

–By Howard Gleckman

CAPITAL WRAPUP

AN IMAGE MAKEOVER FOR THE GAO

THE GENERAL Accounting Office—the congressional watchdog agency that has angered partisans over the years with its maverick ways—exists no more. No, it hasn't been abolished. Instead, Congress has renamed it the **Government Accountability Office**. The GAO's mission won't change; it still aims to hold officials accountable for the way they spend taxpayers' dollars. But lawmakers are hoping to update the GAO's image from old-fashioned green-eyeshade accountants to sleuths ferreting out waste, fraud, and abuse.

AFRICAN AMERICANS: BUSH COMES IN THIRD

JUST HOW unpopular is **President Bush** among African Americans? He's in last place among black voters, with 9%, behind **John Kerry** (73%) and **Ralph Nader** (10%), according to a July 9-30 Gallup Poll. If there's any reason for Republicans to cheer, it's that Nader's hard-left, anti-corporate message is, for now, siphoning liberal urban support from Democrat Kerry.

THE WHITE HOUSE TAKES AIM AT CRAWFORD'S REP

FOR FOUR YEARS, the President's hometown has been represented in Congress by a Democrat, **Chet Edwards**. So Bush is pulling out all the stops to replace the centrist Edwards with conservative Republican **Arlene Wohlgemuth. Vice-President Cheney** raised $300,000 for her in April. Next up: White House political guru **Karl Rove** is planning a July 29 event, while Edwards is hanging out in Boston with liberals at the Democratic National Convention.

INDIA

RATAN TATA: NO ONE'S DOUBTING NOW

He has transformed Tata from an overgrown conglomerate into an agile global force

THE ENTRANCE TO BOMbay's Birla Matushree Auditorium is festooned with blue and red bunting. Outside, scores of people mill about as waiters serve free coffee and soda. Suddenly a flurry of excitement sweeps the crowd. What's the attraction? No, it's not the latest Bollywood starlet. It's a tall, graying man in a conservative suit: Ratan N. Tata, 67-year-old chairman of the Tata group, arriving to lead the annual meeting of Tata Motors, the group's largest company. "When Ratan Tata is there, you don't have to worry about anything," says longtime shareowner Pravin D. Shah.

Tata, India's largest conglomerate, has certainly achieved the kind of results that set shareholders' hearts aflutter. The group's revenues are up 30% since 2002, to $12.8 billion last year, and profits have grown 60%, to $1.2 billion. Stock prices of the group's biggest publicly traded companies, Tata Motors and Tata Steel, have tripled in that period. And this summer, Tata is expected to raise $1.2 billion by selling 13% of Tata Consultancy Services (TCS), Asia's largest software-services player and pioneer of the outsourcing business that has fueled India's economic boom. "TCS exemplifies our dual thrust: It is a dominant player within the country, but it will also focus our growth outside India," Tata says.

It's a sweet moment for the gentlemanly Tata. Since 1991, when he took over as chairman from his uncle J.R.D. Tata, he has faced plenty of opposition as he dragged the group out of the cozy—but stifling—embrace of socialist India and streamlined the overgrown conglomerate. J.R.D. Tata had been a darling of the Indian Establishment, but many observers were skeptical about his untested nephew. Ratan Tata's plan—sketched out a decade before he became chairman, back when he ran the group's business-development arm—was to build a more focused company without abandoning the best of Tata's manufacturing tradition. It took the better part of a decade, but Tata's vision is paying off. "The group is now well-positioned to benefit from India's rapid growth and evolution as a global sourcing base," says Amit Chandra, a managing director at investment bank DSP Merrill Lynch Ltd. in Bombay.

The group has come a long way in its 136-year history. It was founded in as a textile-trading business, then the country's first steel mill and h electric plant. Since then, Tata ha come interwoven with the fabric of an life. Indians season their food Tata salt, drink Tata tea, drive Tata wear Tata watches, and use Tata's p and phone networks. Now, Ratan wants the world—not just India—to brace Tata products. So for the past years he has been in a global expar mode. In 2000, Tata Tea Ltd. paid $ million for Britain's Tetley Tea to g ready-made international brand. March, Tata bought Daewoo's com cial-truck operation for $102 millio Britain, MG Rover Group Ltd. is se Tata-built Indica compact cars unde own brand name. And the lodging sion and TCS are expanding abroad.

DOING WELL AND DOING GOOD

TATA ISN'T NEGLECTING his home though. He's developing afforda high-quality products and services fo emerging class of Indians with big a rations but limited means. In June, T Indian Hotels Co. launched indiOn chain of $20-a-night hostelries that

Tata's Stable

The group owns more than 80 companies that make everything from salt to steel. Some of the biggest:

TATA MOTORS

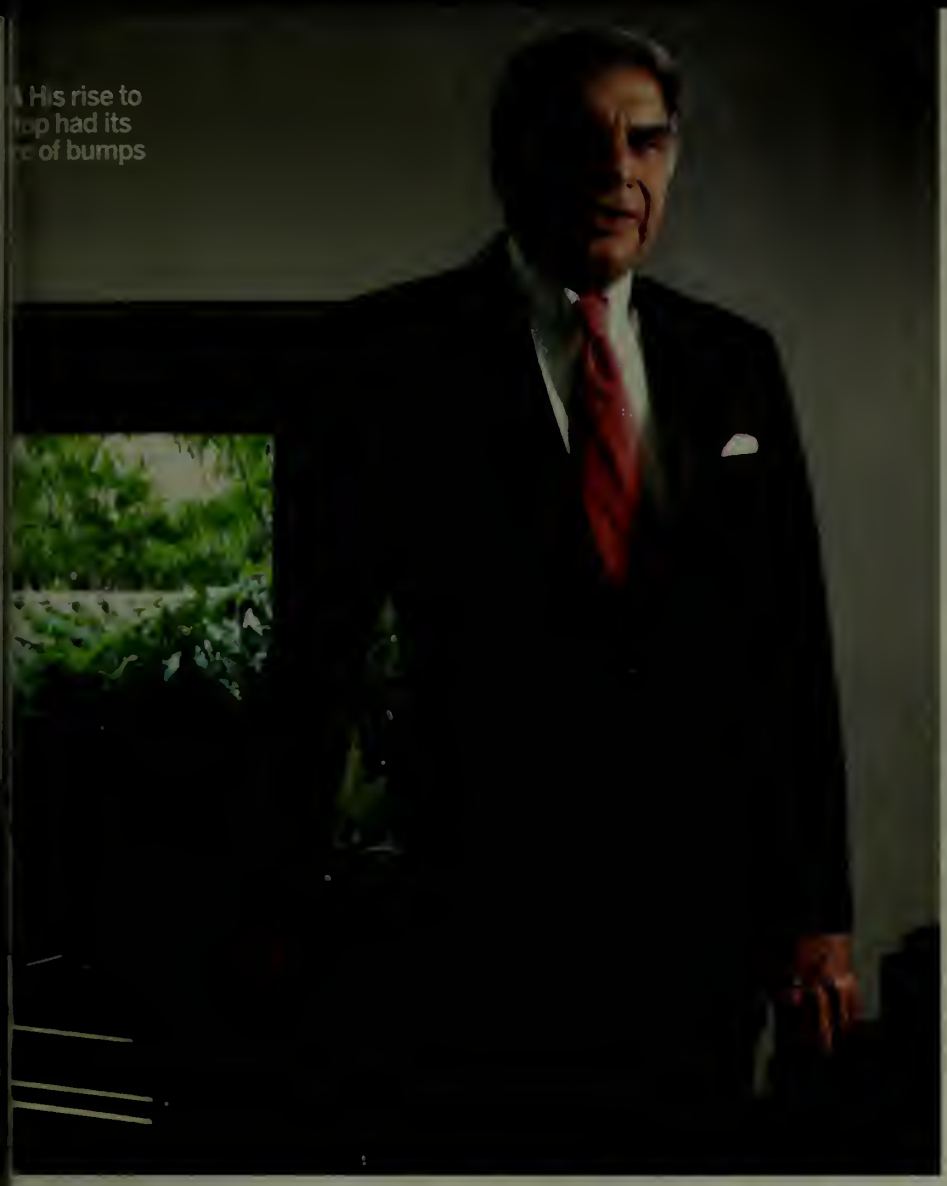
The country's leading truck- and carmaker is expanding exports and working on a $2,200 sedan for India's eager new consumers.

REVENUES	SALES GROWTH
$3.4 Billion	41%

TATA STEEL

Profits at India's larg steel company grew year. This year it pla expand output by ov to 6.7 million metric

REVENUES	SAL
$2.4 Billion	2



His rise to
op had its
e of bumps

Wi-Fi connections and flat-screen . Next year, Tata Motors plans to roll the first prototype of a four-door car ected to sell for just $2,200. Tata says ventures are meant to be profitable, he admits he is also motivated by a ily tradition of charity and good ks. "It's the foundation on which the p was built," says Tata. Investors are ching to see whether such a model generate the kind of profits they're acomed to seeing from Tata. "If anyone pull it off, it's the Tatas," says Ajay dhi, managing director of investment bank Kotak Mahindra Capital in Bombay.

Tata's riskiest bet may be on telecom. In 2002, the group paid $530 million for 46% of the state-owned international telecom monopoly, VSNL. That investment has been something of a lemon. The sector was deregulated soon after, and instead of benefiting from the monopoly, Tata faced a flood of new rivals. Tata has also invested $2 billion in licenses and infrastructure for a mobile network, but in 18 months it has attracted just 2 million subscribers and is fifth in the market. Ratan Tata nonetheless plans to invest an additional $3 billion to expand the network. Investors are lauding the move. "The group was conservative on telecom for too long," says Dinshaw Irani, who heads portfolio management at Bombay brokerage SSKI Investor Services.

"Ratan's folly" is now one of India's best-selling autos

Tata's boldest moves have come at Tata Motors. When Tata took over as chairman, the truckmaker had too many employees and suppliers, and costs were climbing while market share was slipping. So Tata halved the number of suppliers, to 600, and instituted a rigorous quality-control program in the company's factories. He also introduced a voluntary retirement scheme to trim employment by 40%, to 22,000. Then he fulfilled a long-cherished dream of his uncle's by making a move into passenger cars. In 1991, Tata Motors introduced a station wagon and later a sport-utility vehicle. Then, in 1999, amid much skepticism, he invested $400 million in the Indica, a four-door hatchback that sells for just $5,100. Despite being derided as "Ratan's folly," the Indica has been a great success—it's now the third-biggest seller in India.

Will Tata realize his dream of remaking the group into a global giant? There are plenty of hurdles ahead, and Tata doesn't have much time—he retires in three years. He won't disclose his succession plan, but the market is abuzz that Ratan's half-brother, Noel Tata, 47, who runs the group's small retailing business and hasn't had a high profile, will inherit the mantle. For now, though, the show is all Ratan Tata's, and Indians—and the world—are watching. ■

–By Manjeet Kripalani in Bombay

BusinessWeek online For a Q&A with Tata group Chairman Ratan Tata, go to www.businessweek.com/magazine/extra.htm

NSULTANCY ES

ggest software-company is expected ome $1.2 billion this summer.

ES	SALES GROWTH
illion	27%

TATA INDICOM

Big telecom bet: The group spent $530 million for 46% of international carrier VSNL. Plotting a $5 billion expansion of its mobile operations.

REVENUES	SALES GROWTH
$1.1 Billion	-10%

TATA POWER

Provides electricity to Bombay. It's turning to distribution and has begun expanding in New Delhi, but growth remains sluggish.

REVENUES	SALES GROWTH
$942 Million	Flat

INDIAN HOTELS

The luxury-hotel group has refurbished its properties and is expanding overseas. Launching a chain of $20-a-night business hotels across India.

REVENUES	SALES GROWTH
$155 Million	17%

All revenue and growth data are for fiscal year ended Mar. 31, 2004 **Data:** Company reports, Bloomberg Financial Markets

IN GERMANY Siemens has cut jobs 23% since '92

GERMAN

CAN A U.S.-STYLE BOSS REV UP SIEMENS?

CEO-designate Kleinfeld may meet resistance from labor and execs at home

IT'S SAFE TO SAY KLAUS KLEINfeld didn't have much trouble adjusting to life in America after Siemens made him chief operating officer of its U.S. units in 2001. He won invitations to join the boards of organizations such as the Metropolitan Opera and Alcoa Inc. He ran two New York marathons. He did so well he became CEO of the U.S. business in 2002.

Now, Kleinfeld, 46, is set to become the latest German manager to parlay U.S. experience into a top job at home. On July 7, Siemens announced that, effective in January, Kleinfeld will succeed Heinrich von Pierer as CEO of the $89 billion Munich conglomerate, which makes everything from light bulbs to power plants. The question is whether Kleinfeld will fare better than some other German bosses who tried to import U.S.-style techniques, with their emphasis on speed and profit. "Kleinfeld stands for the modern approach of trying to cope with globalization and move out of the old, well-trodden path," says Jens van Scherpenberg, head of the Americas Research Unit at the German Institute for International & Security Affairs, a Berlin think tank.

Trouble is, others who fit that description haven't always fared so well. Remember Thomas Middelhoff, the self-styled "American with a German passport?" He was ousted as CEO of media giant Bertelsmann in 2002 after disagreeing with the controlling family over plans to go public. The hard-charging Ulrich Schumacher, CEO of chipmaker Infineon Technologies, lost his job in March.

Kleinfeld, a member of Siemens' corporate executive committee, seems to combine an ability to push change an antenna for human nature. "H longs to another generation, bu knows Siemens culture," says R Berger, chairman of Munich-b Roland Berger Strategy Consultants

COOPERATING FIEFDOMS

KLEINFELD'S FINGERPRINTS wer Siemens' decision, also announce July 7, to merge the mobile phone div with the land-line telecom unit. He managed to get Siemen's fiefdoms t operate more on marketing. One re the contract to provide everything telecom gear to computer network Houston's $750 million Reliant Park vention and sports complex. After a million loss in 2001, Siemens posted its of $810 million for its U.S. uni 2002 and $561 million in 2003. "He instrumental in getting it working," Gerhard Schulmeyer, Kleinfeld's pr cessor in the U.S.

Back home, Kleinfeld will hav spend a lot of time on labor relati Von Pierer has reduced the Ger workforce by more than 50,000 167,000, since becoming CEO in 1992. by imposing cuts gradually, he mana to avoid serious confrontation with many's powerful labor unions and t political allies. That's getting harder. bor leaders are sore that they were fo recently to give in to demands that w ers at a mobile phone factory put in e hours without extra pay: Siemens thr ened to shift the work to Hungary.

Shareholders are also restive. Siem shares have fallen 8.9% this year, 6.9% gain for rival General Electric While Siemens earned $1.45 billion sales of $21 billion in the last qua problem areas exist. The telecom g businesses have wobbly margins, and transportation unit is enmeshed in a c ly recall of streetcars. So Kleinfeld will pressure from vestors to s down Siemens e further. Kleinfe academic resea at the Universit Göttingen focu on the intersect of psychology economics. If can reconcile man nature w economic reality Siemens, he mi just succeed. ■

–By Jack Ew in Frank

BIO

Klaus Kleinfeld

AGE: 46

FIRST CORPORATE JOB: Product manager at drugmaker Ciba-Geigy (1986).

SIEMENS HIGHLIGHTS: Head of Corporate Projects (1994); CEO of U.S. operations (2002); appointed to Siemens management board in December, 2002, responsible for telecom units; will succeed current CEO Heinrich von Pierer next year, subject to supervisory board approval.

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COMMENTARY

BY JASON BUSH

Murder Most Foul in Moscow

A journalist's killing casts more doubt on Russia's commitment to a civil socie

FEW CAN DENY that in recent years, under the Presidency of Vladimir V. Putin, Russia has become a more stable, orderly, and predictable society. That's certainly how it seemed to Paul Klebnikov, editor of the recently launched Russian edition of *Forbes*, and many others. "Russian business has reached a new, more civilized stage of its development," he wrote in the magazine's first edition in April. Those words now seem tragically ironic, coming just a few weeks before Klebnikov's cold-blooded killing on June 10, when the journalist was shot dead in a contract-style murder outside his offices in Moscow.

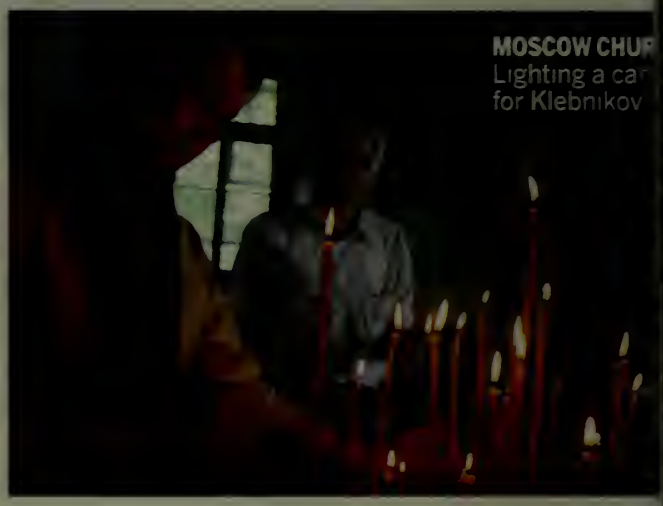
Murders of journalists, businessmen, and politicians are still depressingly common in Russia, though their frequency has been declining in recent years. But the murder of Klebnikov, 41, a U.S. citizen, is more than just one more entry in this grim catalog of assassinations. Even at the height of the violence in the 1990s, Russia's gangsters observed some limits. Klebnikov's murder is the first time a Western journalist has been killed.

There are still few real pointers as to who may have ordered Klebnikov's killing or why. Boris Timoshenko from the Glasnost Defense Foundation in Moscow, an organization set up to defend journalists, says that while the police may be well-intentioned, their investigations often lead nowhere, because of pressure or intimidation by the groups responsible for such killings. "I fear this case won't be any different from the long-established practice: They may find the killers, but the people who hired them go unpunished," he says.

One can only hope that Timoshenko will be proved wrong. But one thing is clear: The mood in Russia is darker than it was in March when Putin was reelected in a landslide victory. Putin started his new term by promising to continue reforms that would make society more prosperous and fair. That included clamping down on corrupt bureaucrats and judges, and pushing ahead with measures to liberalize the economy.

But since then, the government of this law-and-order President has acted in ways that have prompted neither law nor order. The bureaucracy is in disarray after

KLEBNIKOV


MOSCOW CHUR
Lighting a ca
for Klebnikov

Putin slashed the number of government ministries in A leading to long delays in getting approvals for foreign in ments. The Central Bank helped spark a run on deposi bungling a crackdown on shaky banks. Then there's th evasion case against the Yukos Oil Co., which has hamm investor confidence by pushing one of Russia's largest c panies toward bankruptcy. Investors had hoped that the ter would quietly wind down after Putin's reelection. Inst the confrontation has escalated. The longer it goes on. more arbitrary it looks. Yukos recently has made severa forts to negotiate a settlement over paying back taxes but been ignored or rebuffed. And the government is put Yukos in an impossible position by freezing the com ny's assets while demanding that the company pay billior dollars immediately. Punishing Khodorkovsky looks more portant to Putin than strengthening the rule of law. At same time, Putin has tightened state controls over televi even further

Although Klebnikov's murder is not directly connected to Yukos affair, it greatly adds to the growing disquiet about rule of law and civil liberties Putin's Russia—and Putin's ability to make Russia safer more predictable. The authoritie have a chance to dispel the dou about the justice system and t overall commitment to a civil so ty. They can push the investigat into Klebnikov's murder with utmost vigor and bring all the prits to justice. That's the kinc *glasnost* Russia badly needs. ■

Just months after Putin's landslide reelection, the mood is darker

TED BY ROSE BRADY

srael: Why Peres May oin Up With Sharon

AT DOES SHIMON PERES WANT? On July 12 the Israeli Labor Party der entered negotiations with Prime Minister Ariel Sharon to up a national unity government. Peres, 81, thinks he can ke one last push for peace with the Palestinians by giving ron the support he needs to win Knesset approval for his roversial "disengagement plan."

e plan, which calls for the dismantling l 21 Jewish settlements in Gaza and in the northern West Bank by Septem- 2005, has raised the ire of the Israeli t—including some members of on's Likud Party. "I will not forgive lf if, because of our hesitations over her to join the government, the disen- ment is not implemented," Peres de- d after his meeting with Sharon.

res sees disengagement as a turning t in Israeli politics. For the first time, ers would be leaving Gaza and the t Bank, and Peres hopes their depar- could lead to the elimi- n of dozens more West k settlements as well as egotiations for a Pales- n state adjacent to Is- s pre-1967 border. By ning the government, h Labor quit in 2002, s is gambling that he have a say in any unfold- political process. "Peres stly believes he cannot an election, and there- the best way for him to ence events is from in the government," a political confidant.

ome analysts, however, e that Peres is suffering wishful thinking and will be unable to the tough Prime Minister. Sharon, 76, s disengagement as a unilateral move ssary to separate the hostile communi- and protect Israelis from suicide bers. That's also why the government ilding a 450-mile security fence. But tics doubt Sharon will follow up these es with negotiations for a Palestinian . "Sharon is trying to avoid [a peace ess] at all cost," says Henry Siegman, senior fellow on the Middle East at the Council on Foreign Relations in New York. "From Labor's point of view, it's hard to see how [joining a national unity government] serves their purposes." Siegman predicts that Labor will seriously undermine its credibility in advance of elections in 2006 if it joins a Likud-led coalition.

PERES Will he help Sharon win Knesset approval for a pullout?

Hot Political Summer

THE SHAPE of the new government will depend on talks that could stretch to October, when the Knesset returns from its summer recess. Peres will bring Labor's 19 Knesset members to the coalition—enough to give it a legislative majority. He is demanding a detailed timetable from Sharon for the Gaza pullout and key Cabinet positions for Labor. Peres also may push for a softening of Finance Minister Benjamin Netanyahu's austere economic policies. They are credited with restoring Israel's economy to growth—forecast to be 3.8% for 2004—but haven't curbed its 10.8% unemployment. Sharon needs Labor's support to win approval for his 2005 budget.

Even if Peres and Sharon can reach agreement, it could still be a hot political summer in Jerusalem. Likud party rebels opposed to Sharon's disengagement plan are trying to torpedo the proposed national unity government. If Sharon fails to persuade his party to bring Labor into the government, his only alternative will be to hold early elections. That would delay the pullout from Gaza and close the first tiny opening for the peace process in years. This summer, Peres will be doing all he can to stop that. ■

–By Neal Sandler in Jerusalem

GLOBAL WRAPUP

A NEW FIGHT OVER DEFICITS IN EUROPE?

CHALK UP one victory for small countries in Europe angry at big nations such as France and Germany for bending the rules. The **European Court of Justice** decided on July 13 that European Union Finance Ministers were wrong last November not to discipline France and Germany for breaching EU rules limiting national budget deficits to 3% of gross domestic product. The decision vindicates countries such as Austria and the Netherlands, which had wanted to sanction the euro zone's two largest members, but no penalties will be imposed.

And the problems enforcing budget discipline aren't over. A new battle is expected pitting France and Germany against their smaller partners. The larger countries want the economic limits to be more flexible, while the smaller partners want them to remain strict. One compromise making the rounds in Brussels: giving countries more time to cut deficits if they make wide-ranging structural reforms.

CHINA-SINGAPORE TIES TENSE OVER TAIWAN

SINGAPORE DEPUTY Prime Minister **Lee Hsien Loong** paid an unofficial visit on July 10 to Taiwan, just weeks before his assumption of the city-state's premiership. He was following in the footsteps of his father, Lee Kuan Yew, who had attempted to bridge the gap between China and Taiwan. The younger Lee met Taiwan President Chen Shui-bian and opposition leader Lien Chan. Beijing expressed strong dissatisfaction, warning of severe consequences if military cooperation steps up between Singapore and Taiwan.

Is Japanese Style Taking Over the World?

From video games and cartoons to cell phones and cars, Japan influence on pop culture and consumer trends runs deep

JUSTIN ZELADA AND STEVEN Hausdorfer are 17-year-olds from suburban Los Angeles. Over the recent July 4th weekend they ventured south to Anaheim, not to visit Disneyland but to attend Anime Expo 2004 at the convention center next door. Fans of *anime*, the distinctive Japanese-style cartoons, the pair even dressed like two of their favorite characters, one in a samurai-style headband and sword, the other in a fur cape with one hand disguised as a giant gold hook. Says Hausdorfer: "Some of my friends think everything Japanese is cool."

Indeed, *anime* is just the most visible sign of a growing trend. In the last few years, Japan has become a rising force in a wide swath of fashion-focused industries, from kids' toys to entertainment, cell phones, and car racing. In an April report, Tsutomu Sugiura, director of the Marubeni Research Institute, figured Japan's cultural exports, including music, books, magazines, films, handicrafts, collectibles, patent royalties, and performances at $15 billion in 2002, up from $5 billion in 1992. That, of course, doesn't include Japan's influence on products made elsewhere. As evidence that this is just the start, Sugiura estimates that almost 3 million people outside Japan are now studying the Japanese language, up from 1 million in 1990.

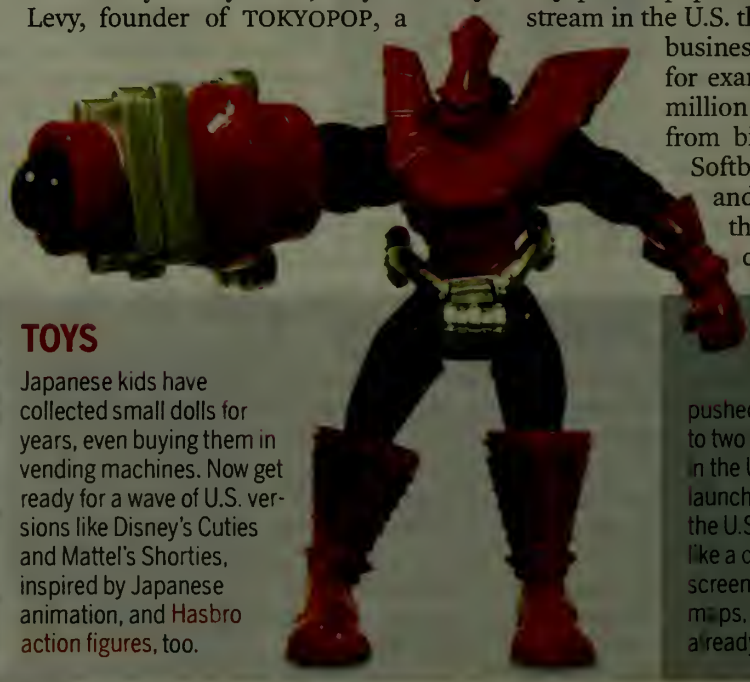
Much of Japan's cultural output travels to other parts of Asia, but, increasingly, U.S. consumers are embracing Japanese style, too. The distinctive look of *anime*, with its wide-eyed characters, is influencing toys, cartoons, comics, video games, even movies. And while U.S. kids have been enthralled with Japanese exports before—from Godzilla to Nintendo—the breadth of products has never been greater and their acceptance goes far beyond the Cartoon Network crowd.

Now the popularity of *Kill Bill, Iron Chef,* and even evergreen properties like Hello Kitty shows how deeply Japanese culture is weaving its way into the fabric of America. "High-school girls in Japan are the key to any trend," says Stuart J. Levy, founder of TOKYOPOP, a Los Angeles-based publisher of Japa style comics called *manga* that a thick as paperbacks and sell for apiece at retailers such as Target Borders. "They are the center of pop ture today."

GETTING THE DRIFT

FOR U.S. CULTURE merchants, the sequences of that shift could be profo Instead of watching for trends to em from urban America that can be p aged, mass-produced, and sent over marketers will have to become ju adept at importing trends as expo them. "The U.S. has for a very long been the center of global culture. It i only place that had that kind of cach movies, music, food—but now that longer true," says Anne Allison, cha cultural anthropology at Duke Unive

Japanese pop culture is now so m stream in the U.S. that it has become business. TOKYOPOP's I for example, has raised million in venture ca from big investors such Softbank Finance C and Mitsui & Co. an the past year has cu censing deals



What's Japanese and Hot

The Land of the Rising Sun is having a big impact on a variety of fashion-focused industries

TOYS

Japanese kids have collected small dolls for years, even buying them in vending machines. Now get ready for a wave of U.S. versions like Disney's Cuties and Mattel's Shorties, inspired by Japanese animation, and Hasbro action figures, too.

CELL PHONE

Intense [illegible] pushed Japanese [illegible] to two generations [illegible] in the U.S. Soon [illegible] launch the first Jap[illegible] the U.S.: Closed, the phone like a camera, but it also [illegible] screen for text [illegible] maps, etc. [illegible] already big in Japan.

ANIME ASSAULT Toons such as *Duel Masters* are flooding the U.S.

U.S. media giants Viacom, 20th Century Fox, and Walt Disney. The careers of Japanese artists Takashi Murakami and Yoshitomo Nara are on the ascent; at Sotheby's contemporary art auction last May, their quirky characters and patterns sold for record prices, hundreds of thousands of dollars a pop. Louis Vuitton's chief designer Marc Jacobs loves Murakami's work so much he asked him to design a series of handbags that are now a $300 million global business for the luxury goods giant.

Japanese leisure is also infiltrating U.S. culture. Consider "drifting," a professional motor sport that was born on the twisty mountain roads of Japan. Drivers compete by taking sharp turns on oval tracks that leave their cars skidding sideways. They are judged by how well they handle the drift, the level of smoke generated by their squealing tires, and how close they get to the track's wall without hitting it.

American trend-spotters now have to look to the East

The first professional drifting circuit was launched in the U.S. this summer, and although drivers and judges are mostly Japanese, the trackside sponsors are Western heavyweights, including DaimlerChrysler's Mopar parts division and Cooper Tire & Rubber Co. "This is the opposite of NASCAR," says Mark-Hans Richer, marketing director for General Motors Corp.'s Pontiac division, which is sponsoring a team driving its new GTO. "It's not broad and huge. It's bubbling up."

In the toy industry, where Japanese influence has reached gargantuan proportions in the wake of hits like *Mighty Morphin Power Rangers* and *Yu-Gi-Oh!*, manufacturers have started to co-develop toys for the U.S. and Japanese markets si-

CARS

Japanese carmakers have kept Detroit spinning with new technologies such as Toyota's gas-electric Prius and through much-improved design, such as Nissan's futuristic Titan pickup. The next import: a hot new motor sport called drifting.

FASHION

Tokyo's Harajuku and Shibuya neighborhoods long ago became the epicenter for trends. Now Japanese fashion is making waves on Seventh Avenue, too, with designers like Junya Watanabe and Jun Takahashi gaining acclaim and Vuitton's Murakami bags draping many a famous arm.

PASS THE WASABI Samurai fight scenes provide the action in the hit *Kill Bill* movies

multaneously. That's what Hasbro Inc.'s Wizards of the Coast division did with Japan's *manga* publisher and entertainment giant Shogakukan Inc. in creating *Duel Masters*, a new TV show and trading-card game. But it wasn't until after the story and its hero, Shobu Kirifuda, became a hit in Japan that Hasbro brought it to the U.S. "If something is successful in Japan, there's a story to tell to retailers here," says Joe Hauck, a vice-president at Wizards of the Coast who is in charge of the property.

Japan's rising worldwide cultural influence has a lot to do with changes which have taken place within Japan. The country has developed more of a leisure class. Young Japanese women, for example, now work in high-paying jobs but still live at home with their parents, giving them plenty of disposable income. They spend it on everything from upscale fashions to pricey collectible dolls.

Oddly, Japan's economic slowdown over the past decade may have also played a role. The potential for superior investment returns has Japanese industrial giants such as Mitsubishi, Nippon Telegraph & Telephone, and Japan Railways Group backing kid entertainment properties such as *Pokémon* and *Duel Masters*. Designers and businesspeople who might have worked for large corporations for life, found themselves out of work and forced to be more entrepreneurial. Many of the nation's most creative products in entertainment and fashion are started by small companies that license their work to larger ones. "This is pretty similar to the punk rock revolution in England in 1970s," says Ken Miller, editor of *Tokion*, a U.S.-based pop-culture magazine with half of its 150,000 subscribers living in the U.S. and half in Japan. "You're getting access to a culture parallel to yours but reacting to [the world] in different and interesting ways."

THE VALUE OF STYLE

PART OF THE JAPANESE cool factor is the result of the new competiton from China and Korea. Forced to compete with lower-cost products, Japanese designers have differentiated their goods by adding a bigger element of design and fashion. Toyota Motor Corp., for example, has had a big win in the U.S. with its Scion xB, a distinctly boxy wagon aimed at younger drivers that was originally a hit in Japan. In cell phones, Japan is a design innovator, first championing cell-phone cameras and now using phones for paid services from cartoons to local weather reports and maps. Juha Christensen, president of mobile and devices at software maker Macromedia Inc., always stops by Akihabara, an electronics district near Tokyo, on his business trips to Japan. "Japan is a great place to look at to find the trends we will see here in two to three years," says Christensen.

BROOKLYN BORN Some 10,000 Japanese-influenced Ugly Dolls are selling a month

The missi
go beyond
checking ou
latest Jap
trends to tryi
seed the m
Sneaker king Nike Inc., for examp
leases a few pairs of new shoes in
and can count in days the time it tak
them to start appearing on the f
trendsetters in New York. "Kids con
Tokyo, New York, London, and Los
les," says Roger Wyett, a marketing
with Disney's consumer-product div
"If you establish yourself in those
products move around very quickly-
very virally."

At the same time that changes
been sweeping Japan, the U.S. has
been going through a cultural meta
phosis. Many U.S. consumers are si
bored with the traditional symbo
popular culture. And young Amer
lean more to individual pursuits tha
their predecessors. Team sports su
football, baseball, and basketball ar
clining in popularity, notes Harvey L
president of the research firm Ame
Sports Data Inc. The number of U.S
idents practicing Asian martial arts,
ever, has seen a 28% increase, to 6.9
lion, over the past five years.

Meanwhile, American kids who
up playing Japanese video games are
expanding their interest to other Ja
ese-inspired products, or even cre
their own. Take Ugly Dolls, a line of
fabric dolls co-created by David Hor
a 33-year-old commercial artist
grew up playing with Japanese v
games and robot dolls that his father
advertising executive—brought h
from Japan. Horvath says his whim
figures were inspired by his early lo
Japanese cartoons, toys, and comics.
now selling 60,000 a month in st
from Barneys New York to special
Asian culture boutiques like Giant Ro
"We get people from America looking
Ugly Dolls because they think it's this
thing from Japan," Horvath says. "
cool thing is from Brooklyn."

Pop culture trends are notorio
fickle, of course, and tastes can cha
overnight. For now, however, if
want to find out what's hot, ask a Ja
nese schoolgirl. ■

–By Christopher Palmeri in Los Ang
and Nanette Byrnes in New

BusinessWeek online For a slideshow of influential Japanese design and a story about the Internet's role, visit www.businessweek.com/magazine/extra.

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High-Tech Homers

New bats let players—and sports companies—score big

DANIEL DELL DOESN'T look like he'd need help swatting homers out of the park for his various softball teams. But the 6-foot, 4-inch 310-pounder takes nothing for granted. His bat bag is stocked with an arsenal of nearly a dozen bats made of aluminum, carbon fiber, and other composites. Physicists and engineers have lost sleep over these bats. Enlisted by Wilson, Nike, Louisville Slugger, and the like, they're scrutinizing new materials and bat structure to get the kind of performance that will be worth $300 or more to hitters like Dell.

THE PHYSICS FACTOR

AND THE VERDICT? The new bats have "totally revolutionized the game," says Dell, a 27-year-old registered nurse in Norman Park, Ga., who spends $2,000 a year on bats. "They've taken guys who can't hit the ball out of the ballpark and turned them into giants."

High-tech bats have quickly become must-have equipment for nearly every slow-pitch softball player, from recreation league novices to elite sluggers. It all began about 10 years ago, when tiny DeMarini Sports of Hillsboro, Ore.—now a unit of Wilson Sporting Goods Co.—started crafting bats from thin double sheets of aluminum. Since then softball, like golf, tennis, and cycling, has been transformed by exotic alloys, fibers, and resins. Physics and computer modeling have also kicked in—almost to a fault: The latest *über*-bats have so changed recreational softball that some leagues have banned them.

What causes the balls to fly off these bats is a nifty bit of physics called the trampoline effect. When a pitched ball collides with the barrel of a bat made from thin layers of aluminum or compo ites, the barrel dents slightly, then sprin back to form, adding to the velocity of t hitter's swing.

POWER PLAYER
New bats, like DeMarini's EVO, have prompted some leagues to limit the number of home runs a team is allowed to count

Led by high-end models, bat sales have doubled in the past 10 years, to $170 million

'SECRET SAUCE'

THE REVOLUTION began a decade a with aluminum. But metal alloys had li its: The rigidity of the bat increases at ther end—near the handle and the tip making it harder for batters to get a sol hit on the outer reaches of the barrel. batmakers turned to composites—typ cally carbon, fiberglass, and Kevlar—a scientists began tweaking the bats' pe formance by changing the ratio of the d ferent types of fibers, as well as their o entation as they wind around the bat. T trick is finding the perfect mix. Too mu carbon wrapped around the barrel r duces the spring, making the bat too sti

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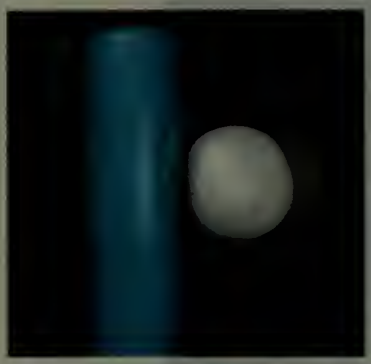
ile an excess of fiberglass laid length-
se would create too much flex. "Do we
ve the best bat that will ever be made?
bably not," says Matt Vacek, vice pres-
nt of engineering at Miken Sports,
ich makes the hot $300 Freak bat.
The designers also tinker with the resin
es, aiming for something that can en-
re constant smacking by the ball. Early
nposite bats cracked, but newer resins
uced the problem. "They might be the
ret sauce to all of this," says Marty
her, president of the
uisville Slugger Div. of
lerich & Bradsby Co.
High-tech bats have so
nanced players' power
t some leagues have tak-
to limiting the number of
me runs a team can hit,
ning subsequent dingers
o more modest doubles.
r of being hit by softballs
squerading as missiles
s led some pitchers to
ar hockey helmets with face masks for
tection. Dozens of leagues around the
ntry have banned some bats.
To protect both players and the bat in-
stry, the Amateur Softball Assn. of
erica last year created a performance
ndard that bats can't exceed. To meas-
a bat's performance, researchers fire a
tball at a stationary bat from a cannon
110 mph—the speed of an average
w-pitch toss, 25 mph, combined with
speed of an elite batter's swing, 85
h. To meet the standard, the ball can-
t come off the bat faster than 98 mph.
at's a step down from the 104 mph that
h-performance bats were reaching
or to the standard, and comfortably
ve the 90 mph the best wooden bats
achieve. "One or two miles per hour
be the difference between a pop fly
d a home run," says Lloyd V. Smith, a
chanical engineering professor at
shington State University, home to one
just three U.S. bat-testing labs.
The new standard has forced bat mak-
s to adjust. "You've got to be creative,"
s Mike Zlaket, vice-president of the
seball and softball division of Easton
orts, the No. 1 batmaker. It's trying to
prove the way the handles of its bats
to increase the whipping motion
on contact. Miken is tweaking its com-
site designs to increase the size of the
eet spot—the area on the barrel that
livers the most power—so hitters can
singles and doubles even if they don't
ke solid contact. Louisville Slugger is
using on durability in its just-
nched $300 Catalyst. And DeMarini is

Batting Physics

Batmakers use three tricks to rev performance:

TRAMPOLINE EFFECT: When the bat collides with a softball, the barrel compresses on impact. The "trampoline effect" comes as the bat springs back to its normal shape. Boosting the effect increases the velocity of the ball.



KICK POINT: Bats flex during swings, with the heavier barrel lagging the handle at the beginning of the swing, and whipping around past the handle at the end. With new composite handles, batmakers try to tune that flex.

COMPOSITE MATERIALS: Batmakers are increasingly moving from aluminum to graphite, carbon, and Kevlar fibers. They tinker with the mix and orientation of various fibers to expand the "sweet spot" of the barrel, giving hitters a better chance at a solid hit.

attaching composite handles to aluminum barrels to improve balance. "We're up against the wall in terms of performance," says Jerry Garnett, DeMarini's marketing manager. "We can only make the bats so good."

New rules, and even bans, aren't likely to dampen batmakers' enthusiasm. In the past decade, bat sales have doubled, to $170 million, accounting for virtually all of the growth in the $443 million baseball and softball equipment business, according to the Sporting Goods Manufacturers Assn. Better yet, high-end bats that sell for $300 cost as little as $100 to make. That kind of math is attracting new competitors. Nike, long an also-ran in the bat business, put a Stanford University mechanical engineer in charge of its bat team eight months ago. It'll have a new batch of alloy bats next year, and composite models in 2006. Just another batmaker lining up to help the world's Daniel Dells hit more balls out of the park without breaking heads or speed limits.

–By Jay Greene in Hillsboro, Ore.

BusinessWeek online For a short video about the "trampoline effect" in high-tech bats, go to businessweek.com/magazine/extra.htm

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A CEO's Last Stand

Scott McNealy knows he made many mistakes. Is it too late to recover?

BY JIM KERSTETTER AND PETER BURROWS

TALK WITH EVER-VOLUBLE SUN MICROsystems Inc. CEO Scott McNealy, and you may hear one of his favorite quips: "Conventional wisdom doesn't contain a whole lot of wisdom." He believes it because of his own experience. Consider 1995: All of Sun's competitors—Hewlett-Packard, IBM, and Digital Equipment Corp.—were busy developing new servers to run the next version of Microsoft Corp.'s Windows software. Wall Street pundits begged McNealy to show some common sense and do the same. But he refused, instead cranking up his investment in Sun's own software, called Solaris. What happened next made McNealy look brilliant. Rivals couldn't match the speed, reliability, and security of Sun's servers. As the tech boom took off, Sun's boxes became the must-have gear for thousands of Internet startups and financial firms. Sales soared; profits exploded.

Six years later, as the boom of the late 1990s came to a crashing end, Wall Street had more advice for McNealy: Batten down the hatches for the storm ahead; slash research; lay off staffers; and get serious about low-cost products. Once again, McNealy [illegible] disagreed. But this time, he was dreadfully wrong. Sun's sales have tumbled 48% in the past three years, it has lost a third of its market share—and it continues to head south even as its rivals ride the economic recovery. Its stock, which reached $64 in 2000, trades at about $4. No other major player has been weakened as much during the tech downturn. "Right now it looks pretty grim," says Geoffrey A. Moore, author of several tech-industry books, including *Crossing the Chasm*.

It's a classic management tragedy, and to a striking degree the responsibility lies with the 49-year-old McNealy. His great strengths—the uncompromising determination, sharp-tongued irreverence, and unblushing idealism—turned out to be critical flaws. Through interviews with 38 current and former Sun executives, including nine departees on the record, *BusinessWeek* has learned that as Sun's situation deteriorated, McNealy was battling not just the counsel of outsiders but also that of his own lieutenants. After the tech industry went into its long slide in 2000, virtually his entire management team, including Chief Scientist Bill Joy and President Edward J. Zander, pleaded with McNealy to scale back his vision and adjust to meaner times.

Time and again, McNealy re-

fused. An economics major during his days at Harvard University, he was convinced that the economy would snap back quickly from its slump, insiders say. Plus, he believed that the Net was so critical to companies that they couldn't hold off buying gear for long. "The Internet is still wildly underhyped, underutilized, and underimplemented," he said in early 2001. "I think we're looking at the largest equipment business in the history of anything. The growth opportunities are stunning." Preparing for the next upturn, he felt, was much more important than whittling expenses for a brief lull.

"I'M NOT GOING AWAY"

AS THE TECH WRECK went from bad to worse, McNealy's contrarian instincts kicked in. After all, he had been right to ignore the consensus within Sun's ranks before. In the 1980s, he overruled execs who were skittish about dropping Motorola Inc.'s microprocessors for chips developed by Sun—a move that paid off in a big way. This time, as his team urged him to cut back, he felt the stakes were even higher. He was determined to fight off what he thought were short-term thinkers, particularly on Wall Street, so that Sun could be preserved as an innovative force. Although he had thought about quitting during the boom, McNealy recommitted himself to Sun in late 2001, convinced that his credibility, experience, and sheer nerve were what the company needed during its darkest days. "I'm here, and I'm not going away. This is a really tough situation, and we're going to get through this," he told staffers at the time, according to former Executive Vice-President Larry Hambly.

Scott's a smart guy. But I don't see a way out."

–Kevin Rollins, CEO of Dell

It would be nice to think that McNealy was doing the right thing. After all, here was a chief executive who was taking the heat to protect his employees, fund R&D, and plan for the long term. Alas, it was not to be. He badly underestimated the severity of the downturn and dismissed customers' desire for low-end servers. As time wore on, the losses piled up, and McNealy's high-minded resolve began to look to others like simple-minded obstinacy. One by one, his team lost faith and departed. All told, almost a dozen of McNealy's most trusted lieutenants have left over the past three years, including Zander, Joy, and John Shoemaker, chief of the server business. Like many others, Masood Jabbar, Sun's longtime sales chief who retired in 2002, says he admires McNealy's courage. But the standoff became counterproductive. "The fight just didn't seem worth it anymore," says Jabbar. "It was an untenable situation."

Now some investors believe it's time for McNealy to his former execs out the door, or at least give up the CE and retain only a chairman's role. Says analyst Andrew Bear, Stearns & Co.: "It's pretty standard that if the ship going toward the iceberg, you change the captain."

But this captain likely will remain at the helm for th seeable future. Two Sun directors who agreed to intervie this article, M. Kenneth Oshman and Naomi O. Seligma the board is squarely behind McNealy. "There's no pl Scott to step down. I think we've got a great leader," says man, CEO of networking player Echelon Corp.

CLOUDS Over S

If Scott McNealy is going to turn around Sun

INVASION OF THE LOW-COST COMPUTERS

Customers have been dumping Sun's pricey homegrown computers for cheaper models based on Intel chips and nearly-free Linux software.

THE PLAN After many false starts, Sun says it's getting serious about the "Lintel" threat. New models equipped with Intel-style chips can run Sun's Solaris, Linux, or even Windows software.

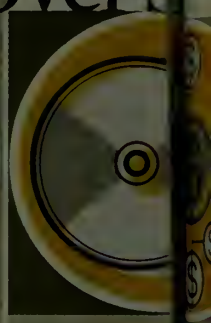
PROGNOSIS Sales of the new products helped drive 20% unit growth in each of the last three quarters, but they're cannibalizing Sun's more lucrative models. With Sun's heavy R&D load, it will have a hard time competing with Dell's efficiency or IBM's scale.

THE INNOVATION DROUGHT

Sun won over corporate buyers with visionary products like its Java software. But recently Sun hasn't advanced its technology enough to stop customers from jumping to low-cost alternatives.

THE PLAN On the high end, Sun is betting on "throughput computing" machines that handle dozens of tasks simultaneously. It's also working on innovative low-end models that include networking features.

PROGNOSIS Throughput computing is the future, but Sun isn't alone. Intel is working on a similar plan, and IBM may beat them both to market next year. The plan for lower-end models is promising. The question is whether customers will pay any premium.



THE MISSI SOFTWAR BUSINESS

Sun has tried beyond its So operating sof to sell other k Net infrastruc programs. Yet still accounts than 10% of re

THE PLAN Sur forged its mar of software int integrated pac and offers a $ employee ann licensing plan cheaper and s than rivals' off

PROGNOSIS Sun remains a distant fourth in corporate infra software, and companies are to swap their ex programs for a only approach. software partne as BEA and Ver resent the com

PHOTOGRAPH BY ALANLEVENSON.COM; ILLUSTRATIONS BY LAUREL DAUNIS-ALLEN/BW

As for McNealy, he says he still has what it takes to bring n back. "Maybe it's time to get rid of me," he says. "But this npany has a lot invested in training and developing me. I ve 20 years' experience. I'm 49 years old. I'm in good shape. althy. Lot of energy. Lot of wisdom. Relationships around world." He seems remarkably unperturbed by the wither- criticism of the past few years. Although he admits to some stakes, he's just as acerbic and cocky as ever. He's not prone self-doubt, or even much self-reflection. "I don't do feel- s," he has said. "I'll leave that to Barry Manilow."

Instead, McNealy is focused on turning Sun around with what he calls "disruptive innovation," the same approach that has saved it so many times before. While most rivals make plain-vanilla computers and slug it out on price, Sun's plan is to change the rules of the game. At the high end of the server market, Sun is developing "throughput computing" chips that can handle dozens of tasks at the same time. At the low end, Sun servers built around Advanced Micro Devices Inc.'s inexpensive chips will handle not only processing tasks but also the basic networking that rivals' boxes can't. And its pricing approach is something no server company has dared try before: It's planning to give away low-end servers to customers that agree to buy its software for several years. "We have a maverick strategy," says McNealy. "I think there's a huge opportunity right now."

He insists that concerns about Sun's future are vastly overblown. He points out that unit sales of the company's servers have risen more than 20% in each of the past three quarters. Despite huge write-offs, Sun has $7.5 billion in cash and investments, including nearly $2 billion from a landmark settlement with Microsoft in April. And he pledges that he's getting serious about whacking away at Sun's bloated costs, having laid off 28% of his workforce in three rounds.

There's no plan for Scott to step down. We've got a great leader."

–Ken Oshman, a Sun board member

While McNealy's plan may look good on paper, it will be difficult to pull off. The new strategy calls for Sun to move in two directions at once: build barebones servers while also inventing cutting-edge technologies. Those are diametrically opposed pursuits, like trying to be Wal-Mart and Gucci at the same time. McNealy contends that Sun is more focused than major rivals. Dell Inc., for instance, sells printers and digital music players, while IBM gets half its revenues from services. "We're not doing digital cameras. We're not doing printers," says McNealy. "We're fundamentally focused, much more so than any company I see out there."

o fix. Here are his challenges and solutions:

PROSPECTS | GOOD | FAIR | POOR

ED
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has cut his by 28% in ree years, s far short of id in sales. spends fully revenues

On Apr. 2, announced cuts. And ging ent ps with Intel, d Fujitsu for Hitachi in

S
be ng e ghtening d cut yearly 500 million, merica Secu- mates Sun will p sales by more to break even. nalysts expect

A DAMAGED CULTURE

For nearly two decades, Sun was admired for its aggressive salespeople and innovative engineers. But now some insiders say a risk-averse, survival-first attitude has taken root.

THE PLAN Sun is giving extra incentives to the salesforce for selling more than Sun's bread-and-butter servers. McNealy brought back Sun co-founder Andreas Bechtolsheim to inspire new design innovations.

PROGNOSIS Until Sun returns to growth mode and the layoffs end, morale will sag. And Sun has tried sales incentives in the past to spur success in new markets, with minimal success.

ONGOING MANAGEMENT TURMOIL

Once known for its seasoned team, Sun is undergoing its second management makeover in two years. Recent departees include respected services chief Patricia Sueltz.

THE PLAN McNealy has let new President Jonathan Schwartz build his own management team, bumping aside some veteran execs. Others, such as Sueltz, left for new opportunities.

PROGNOSIS Sun is more dependent than ever on McNealy, while Schwartz' arrogant style and inexperience have made him controversial with some employees and partners. Sun is facing its worst crisis ever with an unproven team and thin bench.

NO WAY OUT?

BUT SUN'S COMPETITORS are focused in other, potent, ways. Dell concentrates on efficiency and low costs, spending a mere 2% of sales on R&D. That'll cause trouble in basic hardware for Sun, which invests 17% in R&D. At the same time, Sun will struggle to out-innovate larger, and deeper-pocketed, rivals such as IBM. And Sun's track record of diversification is lousy. The reality is that every major initiative to move beyond high-end servers over the past decade

has failed. "Scott's a smart guy, but I don't see a way out for Sun," says Kevin B. Rollins, chief executive of Dell. "Will they disappear? No. But most of the customers we talk to are looking for reasons to use less of their products."

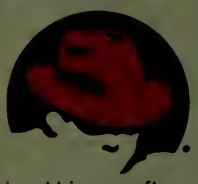
THE JAVA FIX

THE BOTTOM LINE IS THAT MCNEALY'S moves probably come too late to resurrect the icon-turned-also-ran. When the company reports earnings for the fourth fiscal quarter on July 20, analysts expect slight improvements, including stronger low-end sales and narrower losses, excluding special charges. But revenues are forecast to be about 5% below the year-earlier quarter. And for the fiscal year ended June 30, analysts expect revenues to have slipped 4%, to $11 billion, and net losses to have hit $1.2 billion, excluding any gain from the Microsoft settlement. Most industry experts expect larger and stronger competitors, including ibm, Dell, and Hewlett-Packard, to cont making off with blue-chip customers, relegating Sun—and Nealy—to side stage. "Scott is kind of like Moses," says Saffo, director of the Institute for the Future, a Menlo (Calif.) think tank. "[He] led the world to the land of milk honey, but he got left behind."

McNealy's willingness to buck popular opinion dates to his days growing up outside Detroit. His father was chairman of American Motors Corp., and Scott was an acc plished kid—honors student, standout clarinetist, captai the tennis team. One summer, he worked in an auto-parts tory. When the United Auto Workers at the plant wen strike, McNealy didn't think twice about crossing the pi lines—despite bomb threats and jeers from angry union m bers. "It seemed incredibly stupid," he said. "I couldn't how highly paid uaw workers were helping their cause" by ing the company money.

McNealy failed to respond to an economic slump and changes in how customers spend their tech dolla

A Tale of MISSED Opportunities



JAN. 27, 1999 Hewlett-Packard announces that it will load Linux software from leading Linux distributor **Red Hat** on its servers. Within three weeks, IBM and Dell announce similar plans. McNealy, who had received his first report on the Linux threat two years before, refuses to follow suit.

JULY 20, 2000 Sun reports blowout results for fiscal 2000, with profits up 49%, to $1.7 billion, as sales hit $16 billion.

SEPT. 1, 2000 Stock peaks at $64.

SEPT. 19, 2000 Sun spends $2 billion to acquire **Cobalt Networks**, which uses Linux in its servers. But with its own pricey servers booming, Sun never pushes the low-cost models and stifles efforts to use cheaper chips from Intel.

MAR. 8, 2001 Cisco Systems slashes its workforce by 18%. With Sun's sales slowing, McNealy's management team begs him to follow suit. No go.

OCT. 5, 2001 McNealy agrees to lay off 3,900—the last major tech CEO to call for cuts. By this time, President **Ed Zander** has decided to leave after McNealy told him he would stay on as CEO for five more years.

FEB 7, 2002 McNealy dons a penguin suit at an analyst meeting to show his love of Linux. While a new low-end plan is devised to push cheaper Linux servers, McNealy doesn't force Sun's engineers and salespeople to get behind it.

MAY 1, 2002 Sun announces Zander's departure. The company hopes investors will be happy to hear McNealy is taking a more active role in the company. Instead, Sun's stock skids 17%.

OCT. 4, 2002 With sales plummeting, shares hit all-time low of $2.42.

OCT. 16, 2002 McNealy cuts an additional 4,400 jobs, about 11% of the payroll.

MAY 19, 2003 Sun revives its Intel server business and, four years after competitors, starts distributing Red Hat Linux.

JUNE, 2003 McNealy calls Microsoft CEO Steve Ballmer and starts secret settlement talks.

JULY, 2003 Microsoft Chairman Bill Gates visits Sun's headquarters for talks with McNealy and his staff.

SEPT. 10, 2003 Co-founder **Bill Joy** resigns, saying he wants to take time off before starting a new project.

OCT. 16 2003 Even as rivals show signs of recovery, Sun suffers a $286 million net loss—evidence that Sun's ailments go well beyond the economy.

FEB. 10, 2004 McNealy announces t co-founder **Andreas Bechtolsheim** is returning to the company to head development of a new line of servers based on chips made by Advanced Micro Devices.

FEB. 25, 2004 Services chief **Patricia Sueltz** leaves to become president of upstart Salesforce.com.

APR. 2, 2004 McNealy announces a Microsoft détente and anoints Jonatha Schwartz as president. Sun shares rise 19% over the nex two days, to more than $5. B in the next few weeks, as investors digest the news of the 12th quarter of shrinking sales and a $750 million net loss, the stock falls back below $4.

APR. 16, 2004 Schwartz creates distinct divisions for its high- and low-end businesses. Two more execs, chief strategist Mark Tolliver and volume systems head Neil Knox, leave.

le didn't rush to Wall Street or a tech gi- after getting his MBA from Stanford, ei- r. Instead, after "majoring in beer and f," as he describes it, he helped found in 1982, taking on the workaday man- turing duties, while Joy and others ked up the sizzling technology. After be- named CEO in 1984, McNealy quickly wed a bent for making brash bets to e off disaster. Boosting investments in 's Solaris software in 1995 was the lest. Then, as the Net boom began, Mc- ly helped turn Java into Sun's own *ami*. Because Java makes it possible to te Net programs that run on any kind of dware, developers jumped on the band- gon, seeding the market for Sun's gear. The result was a frenzy of sales. By 2000, was turning in scorching growth of % a quarter—faster than Microsoft, Intel, Dell. It racked up gaudy profits, nearly $2 on in 2000. For that short-lived era en quality was an imperative and price no concern, Sun ruled.

But Sun's success laid the seeds for the ble that would follow. The company red billions into R&D for a mind- nbing galaxy of projects—from Ultra- RC chips for closet-size servers to soft- e for smart credit cards. Sun hired 0 new staffers in the year ending July, 1, and opened a 600,000-square-foot dquarters in a refurbished 19th centu- nental-health facility.

Even inside Sun, though, McNealy was eatedly warned about the company's ft underbelly." Three insiders recall a ning session in 1997, when several en- eers made a presentation about the increasing power of low- t chips from Intel. Gene Banman, an exec who had just re- ned from running Sun's business in Japan, argued that Sun ld get a chip from Intel for 30% less than it cost Sun to make equally powerful SPARC chip. Chet Silvestri, who ran chip ign, shot back that his staff would never let that happen. Af- a 20-minute debate, McNealy put an end to the meeting. "I't see the problem here," he said, according to one insider. en he laid down his orders: For the time being, no Sun com- ers would have Intel inside. Today, Intel's processors are ce as fast as SPARC chips, and McNealy admits that his gest regret is "not putting Solaris on [Intel's chips] six or en years ago."

nstead, McNealy continued to insist that Sun rely on its n innovation. A classic example was the September, 2000, chase of Cobalt Networks Inc. By this time many Sun cus- ers were asking Sun for cheaper servers based on Intel ps and Linux, the increasingly popular open-source soft- re. Zander persuaded Sun's board to O.K. the $2 billion ac- sition of Cobalt, which had figured out how to make hefty % margins selling specialized "Lintel" servers costing just 500. With the help of Sun's 8,000 salespeople, Zander felt could turbocharge Cobalt's sales and learn how to compete h commodity products.

t never happened. From the beginning, Cobalt was attacked he heads of Sun's old-line server businesses, who didn't want Sun to invest in the very technology that was threatening their livelihoods. Stephen W. DeWitt, Cobalt's boyish chief executive, became known derisively as the "$2 billion blond." When it came time to set budgets, Cobalt's was cut repeatedly, crippling product development. "The work didn't get done," says former sales chief Jabbar. "The company religion didn't allow it." McNealy says the acquisition was a mistake. "There were some other people who thought it was a good idea, and I trusted them," he says.

SCHWARTZ A sharp intellect—and a sharp tongue

Cost-cutting bordered on blasphemy, too. In late 2000, some of McNealy's top lieutenants began to suggest cutbacks, given that the stock market had been tumbling since March, and cash-starved dot-coms were imploding. Even Joy, a devotee of R&D, says he told McNealy to make a bold move. "I thought we should have cut more sooner," says Joy. "But I could never get the discussion to go anywhere." Around New Year's Eve, Zander grew concerned as well. In one meeting with his staff, he said that Cisco Systems Inc. CEO John T. Chambers had told him Cisco was seeing a large drop in revenues. "Shouldn't we be equally concerned?" he asked the group. "That's when the serious discussions began," says Hambly, the former executive vice-president.

They got a lot more serious on Mar. 8, 2001, when Cisco rocked Silicon Valley by laying off 18% of its workforce. Quickly, Zander's staffers set down the broad outlines of a plan. The consensus was that Sun should cut as many as 20% of its employees, more than 10,000. Many also wanted to jettison the underperforming storage unit and give up on McNealy's hope of creating a viable alternative to Microsoft's Office. "When times are hard, you've got to shoot activities that aren't making money," says Shoemaker, the former server chief.

A DAMAGING EXODUS

McNEALY WOULD HAVE NONE OF IT. Time and again, Zander would end staff meetings by saying: "Well, what do you guys want to do?" says a source who was in the room. As the execs went around the table expressing their views, it was clear everyone believed in some sort of austerity plan—except McNealy.

McNealy was convinced that the Internet had fundamentally changed the nature of the economy. He thought the highs and lows of the business cycle would be far more extreme and short-lived than in the past, with sharp spikes up and down. "We don't have rolling waves," he said during a conference call with analysts in 2001. "We seem to have real edges." If he was wrong, he promised during one session with his execs, he would "take the heat" from Wall Street and Sun's board. Today, McNealy declines to discuss those gatherings in detail but says: "There's a lot of revisionist history out there."

The executive-suite standoff didn't just cost Sun precious

time—it contributed to a damaging exodus. That had started the previous September, say sources, when McNealy and Zander met for their yearly talk about their personal plans. McNealy had been letting Zander run the show, leading the second-in-command to believe he might soon get the top job. But McNealy said he planned to remain CEO for a few more years—prompting Zander to decide to move on, ultimately to the CEO post at Motorola Inc. By mid-2002, half of Sun's top-level executives had departed.

As Sun's fortunes waned, customers and insiders, including outspoken software chief Jonathan I. Schwartz, urged McNealy to change course. A key step: McNealy needed to drop his long-running, and distracting, feud with Microsoft. Finally, last June, McNealy says the customer requests won him over. He swallowed his pride and called Microsoft CEO Steven A. Ballmer.

BILL GATES'S BATHROOM BREAK

BRINGING TECH'S LONGEST-RUNNING feud to a close was not without its funny moments. Microsoft Chairman William H. Gates III visited Sun's headquarters the week of July 4, when the office was closed. The famous exec escaped notice, until he and Sun's chief strategist, Mark Tolliver, went for a bathroom break and ran into a Sun staffer who had come to the office, dog in tow. "He looked Gates straight in the eye, and he had the most stunned look on his face," recalls Tolliver. Still, the meeting stayed secret as negotiations continued over the next few months. Then, early on the morning of Apr. 2, McNealy and Ballmer announced the blockbuster deal. Sun would get $1.95 billion in exchange for calling off two landmark lawsuits. And thanks to a 10-year technology pact, Sun's servers will be certified to run Windows.

The détente was a public-relations coup, at least temporarily. Sun's shares jumped 19% during the two days that followed. But internally, reaction to the day's news was mixed, say insiders. Not only had Sun racked up a net loss of $750 million for the spring quarter, but McNealy had named Schwartz to be Sun's new day-to-day chief. Many say that

> [Scott] led the world to the land of milk and honey, but he got left behind."
>
> *–Paul Saffo, Director, Institute for the Future*

while he is known fo razor-sharp mind, ponytailed 38-yea lacks experience alienates employees customers with his gant style. When Mc told other executives a Schwartz' promotion night before the nouncement, the sil on the phone deafening, accordin former execs.

Today, McNealy is as combative and optimistic as ever. ing a series of interviews, he sketched out bold plans to j back to the fore of the server market. Servers based on S throughput computing chips are expected to hit the mark 2006. Meantime, Sun's experiment with freebie low- servers started in June. The idea is that the low-end ser will open the door for Sun to sell more lucrative software. company is selling a package of its e-business software c Java Enterprise System to corporations for $100 per emp ee per year—a simpler and cheaper alternative to buying f suppliers such as BEA Systems Inc. or IBM.

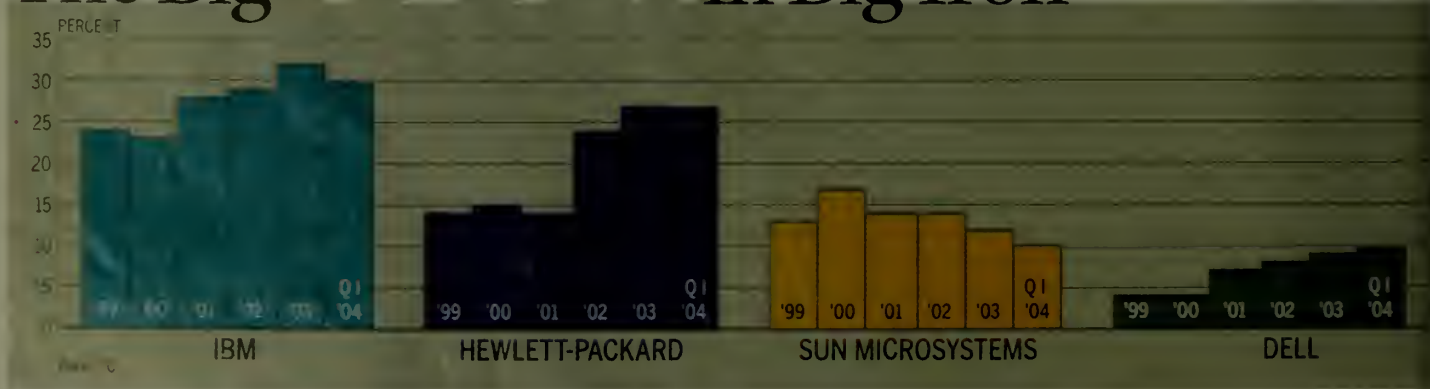
Still, McNealy faces a hard slog to win back credib among customers. For years corporate buyers bought f Sun in part because it seemed to know where tech heading. Now, many believe Sun spent several crucial y with its head in the sand. "They've always had lots of g things on paper. But when it comes to execution, they're l ing," says Gary Feierstein, vice-president for informa technology at Premier Inc., a San Diego company that m ages 1,500 hospitals. "They always seem to be behind wl they need to be."

Therein lies the true tragedy in Sun's decline. Through the company's history, McNealy's risk-taking spirit resulte innovative alternatives to the offerings of giants such as crosoft and IBM. Unless he pulls off a longshot turnaroun may ultimately be a blow to Silicon Valley and even Ameri technological prowess. ■

BusinessWeek online For a Q&A with Scott McNealy, go to www.businessweek.com/magazine/extra.htm

Since the downturn hit, Sun has lost share in the server market, while all of its key rivals have gained.

The Big LOSER in Big Iron



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Research Revolution?

Outside experts are set to pick independent data outfits for brokerages

LAURA S. UNGER HAS BEEN a hot commodity ever since she left the Securities & Exchange Commission three years ago. As both a Wall Street and Washington insider, she has been in demand to help with big bankruptcy cases, serve on corporate boards, and appear on CNBC. Her latest gig has given her special prominence: She is one of ten $500-an-hour consultants charged by regulators to overhaul Wall Street research.

Unger is a key figure in implementing the government's $1.4 billion settlement with the 10 largest Wall Street firms over allegations of tainted research. The April, 2003, pact resolved allegations from enforcers that the firms slanted their stock analysis to favor their investment banking clients. The SEC and New York Attorney General Eliot Spitzer are forcing the firms to spend more than $430 million to distribute independent analysts' reports along with their own. Spitzer and the SEC picked an independent consultant for each firm and charged them with turning an untested idea into reality.

Their efforts could redefine the research industry. Many of the independent shops have labored behind the scenes for years, catering to high-end hedge funds and institutional investors. Now they will get their first full-blown exposure to retail investors—and possibly a big lift for their business. "For me, implementing this part of the settlement meant simply working to create a demand for unbiased research," says Unger. "It artificially creates a robust marketplace for independent research [that] did not happen naturally before."

An artificial market maybe, but one that needed hard work and a lot of shoe leather to fashion. Unger, a former SEC acting chair, has $25 million to spend on independent suppliers over the next five years. She met with at least 40 firms and called many more in her quest to pick the independent researchers for J.P. Morgan Chase & Co. Early in the process she decided to base her choices on the researchers' credibility, the quality of their work, the breadth of their stock coverage, and how much they would charge. Over 13 months, she peppered them with questions: Why did you start your business? Where do you see it going in five years? She studied their sources of revenue and their clients—from tiny hedge funds to big pension and mutual funds. Most important, she examined how their stock picks fared.

> "Many of these shops are very small, with one or two people"

Finally, decision day has arrived. Unger is close to inking contracts with three firms—BOE Securities in Philadelphia, Chicago's Morningstar, and Greenwich (Conn.)-based Renaissance Capital—to provide stock research to J.P. Morgan's customers. The other nine consultants are also finalizing picks for Wall Street giants. From July 26, some 20 million investors who are clients of the 10 firms will get independent opinions on stocks along with their statements.

Each consultant offers expertise in some aspect of the securities industry.

Some hail from money-managemen research outfits; others came from b tique investment banks or mutual fur But the 43-year-old Unger is by far best-known. Because of her regulat savvy, she was asked to serve as a cor rate governance monitor in the Wo Com bankruptcy and as a Justice D trustee in the Enron bankruptcy, but clined. She's now a board member at A bac Financial, Borland Software, MBNA and gets $20,000 a pop for spe ing engagements. It was her CNBC co mentary last year on the ImClone S tems Inc. insider-trading scandal t caught Spitzer's eye. The minute the s was over, CNBC called with a messa Spitzer is looking for you. "I though may have been a practical joker," Un says. It was no joke—Spitzer was call with an offer she couldn't refuse.

The independent consultants' lab

UNGER The former acting SEC chair is consulting for J.P. Morgan Chase

ar from complete. Unger and her co-
s continue to slog through a swamp
icky issues. They meet regularly in
York with officials from the SEC,
New York Stock Exchange, and
zer's office (he hasn't attended any
tings), and the questions have been
ess: how to develop the technology,
xample, to ensure the 10 firms deliv-
e outside research simultaneously
their own reports? If more than one
ide shop covers a stock, which rec-
endation does the Wall Street firm
l out to customers? How to evaluate
independent firm's performance,
e the few companies that track this
different yardsticks? "We've been to-
er a year and every time we [meet],
e other question comes up," says
r Jaffray Cos.' consultant Thomas
ke. Says another: "We've been
ing our buns off."

The enforcers did set some ground rules. Technology upgrades to gather and disseminate the outside reports will be on the Wall Street firms' nickel, not paid for out of settlement dollars. And each firm is stuck with the consultant assigned to it. In other words, no meddling: "They can't fire us," says one consultant. "They can't overrule us."

The selection process, as well as judgments on what defines good research, was left to each expert. "The beauty of this process is that everyone has their own way; this is a grand experiment," says Michael J. Downey, hired to pick outside research sources on 800 companies covered by Bear, Stearns & Co. He interviewed about 60 firms and chose 22. He and Michael A. Dritz, the consultant for UBS Warburg Inc., also hired a third-party consultant, finance professor Fernando Diz of Syracuse University's Martin J. Whitman School of Management, to evaluate the independent firms' research.

For all the lobbying, not many of the outside firms could afford to roll out the red carpet. "Many of these shops are very small, with one or two people," Unger says. Many are housed in nondescript buildings far from the best addresses. Only one took Unger out to dinner. She eventually began bringing her own water bottle to meetings.

MAKING CONCESSIONS

UNGER EXPECTED THE research shops to cater to her wishes in other ways. If they accepted initial public offering stakes in lieu of cash payments, they had to stop. BOE Securities. Chief Executive Bufus Outlaw promised Unger that he'd get out of investment banking to win the J.P. Morgan job (though he had done only four deals since his firm's 1997 launch). BOE, a minority-owned firm, also agreed to start analyzing 180 stocks that Unger considered her "orphans" because her other two choices for J.P. Morgan didn't cover them. "It wasn't a difficult decision," he says. "Our niche is to hustle when our competitors are unwilling to."

Some research houses decided it was all too much trouble. Independent, after all, often means sending reports only when there's something to say. And in order to earn settlement dollars, it means writing pieces that everyday investors can digest. "Our institutional research is written at a very high level," says Bruce A. Gulliver, president of Jefferson Research & Management in Portland, Ore., who was interviewed by several consultants but not selected. "In order to communicate with the average investor, we had to simplify the concepts. It was extremely difficult."

Other firms pursued the business ag-

Second Opinions

Here's what brokerage firms must pay over five years for outside research under the $1.4 billion Wall Street settlement, and the independent shops they've chosen

FIRM / RESEARCH VENDOR	BUDGET (IN MILLIONS)
CITIGROUP Argus Research, Morningstar, Renaissance Capital, Standard & Poor's, Thomson Financial	$75
MERRILL LYNCH BNY Jaywalk*, Morningstar	75
MORGAN STANLEY Not announced	75
CREDIT SUISSE FIRST BOSTON Not announced	50
GOLDMAN SACHS Morningstar, Renaissance, Standard & Poor's	50
BEAR STEARNS BNY Jaywalk*	25
J.P. MORGAN CHASE Morningstar, Renaissance, BOE Research	25
LEHMAN BROTHERS BNY Jaywalk*	25
UBS WARBURG BNY Jaywalk*	25
PIPER JAFFRAY Not announced	7.5

*Multiple providers

Data: *BusinessWeek*

gressively. For instance, Unger met four times with Standard & Poor's Equity Research Services—like *BusinessWeek*, part of The McGraw-Hill Companies—but she passed it over. Citigroup, Goldman Sachs, and some others did choose S&P, though. She says S&P'S research certainly looked "glossy" but choosing a dominant market player didn't sit right with her. "The spirit of the settlement is to foster innovation and competition," she says. S&P says it is already well-represented among the picks for the other Wall Street firms.

Despite her best efforts, the independent firms could be vulnerable. Institutional investors will get free access to the outside research, too, and that's often information they're paying for now. So Unger and her counterparts worry that the independents' main source of income could end up being cannibalized. Some of the independent experts wonder whether the new research will be used at all. Mark Fichtel, the consultant for Lehman Brothers, says: "What happens if nobody cares? I worry about that a lot."

No one knows what will become of this grand experiment in side-by-side research after the five years are ende Wall Street no longer is required t up. "Regulators are hoping [tha seed money will give independe search a foothold that will last b five years," says Scott Cleland founder of Washington (I Investorside Research Assn., certifies that research shops are of conflicts. "The question is, change the course of history?" Eve doesn't, Unger and her colleagu determined to try. ■

–By Mara Der Hovan in New

RATINGS

How the Independents Fared

In the wake of the Wall Street analyst scandals, independent research seemed to be just what ordinary investors needed. The Securities & Exchange Commission and New York State Attorney General Eliot Spitzer certainly thought so when they imposed the $1.4 billion global settlement on 10 investment banks in April, 2003, forcing them to provide such research to their customers. But it turns out that simply eliminating the bankers' conflicts of interest from stockpicking won't make it much easier for investors to beat the stock market indexes.

That's abundantly clear from a ranking of 121 out of some 300 independent research shops now in business compiled by Investars.com, an online analyst-rating service, on behalf of *BusinessWeek*. Only three of the research houses managed to beat the 11% rise in the Standard & Poor's 500-stock index in the year through July 12.

Why were most independents' performances so lousy? Because the surge in the market mainly came from highly speculative, poor-quality stocks that they avoid. That hurt the value investors, who run many of the independent shops: They look for solid companies with good prospects that are selling cheap.

The best performer, Greenwich Investment Research, a tiny upstart, was up over 28%. Over the year, Greenwich principal Chris Hackett recommended just seven investments—both buys and sells—in a fe downtrodden energy and utility stocks. "I a pretty concentrated portfolio," he says.

Most of the independents pick more sto to spread the risks wider. Consider Chica based Thomas White International, up ne 5% in the period. It makes buy and sell recommendations on nearly 2,500 stock "We don't turn lead into gold," says Thoma White Jr., president. White says that, for mo independents, "[performance] looks bette a down market and worse in an up marke You have to look over the lor term and see how they do."

Investors will find those long-term records hard to come by. Although many independent shops have be around for years, the tracke are few and new to the industry. Kei Kianpoor, chie executive of Investars, says his data shows that indepe ent researchers have outperformed Wall Street analysts for the past three years. Of course, there's no guarantee they will mainta that record. However, says Kianpoor, "what matters mo is not the difference betwee Wall Street and the independents but the transparency of the returns and access to the informati by individual investors."

Ratings tables such as ou are just the first step in help investors select an independent researcher to follow. They are the basis for what else?—more research.

–By Mara Der Hovanesi in New Yo

HERE ARE THE 15 TOP-PERFORMING independent research firms for the year through July 12, according to Investars.com, an online analyst rating service. It compiled this ranking by creating a hypothetical portfolio for each firm and then adding or dropping shares whenever the firm upgraded or downgraded the stock. The number of shares varies according to the strength of the recommendation—more shares for a strong buy, for example, than for a buy.

FIRM	ONE-YEAR RETURN	BEST PICK
Greenwich Investment Research	28.25%	Veritas
Parenteau	16.79	Featherlite
Investology Research	14.31	Tom Brown
S&P 500-Stock Index	11.01	
RDEX Research	9.29	palmOne
Argus Research	8.09	eGain Communications
Buckingham Research Associates	7.55	Mandalay Resort
Excalibur Research Group	7.28	Drew Industries
Columbine Capital Services	5.32	LaserSight
Thomas White International	4.95	Tesoro Petroleum
Fulcrum Global Partners	4.89	Urban Outfitters
Standard & Poor's Equity Research	4.40	Factory 2-U Stores
Ford Equity Research	4.37	Impath
Callard Research	3.94	Oneida
When2Trade.com	1.83	Novell
Weiss Ratings	3.73	Factory 2-U Stores

Data: Investars.com

OMMENTARY

/ EMILY THORNTON

A Bad Deal for Women

organ Stanley's modest settlement won't do much to curb sex discrimination

WALL STREET chiefs supposedly earn big bucks because they can rack up big numbers. But they deliver some pathetically nall ones, too. Like zero. That's the num-r of women on the management com-ittees of Bear Stearns Cos. and Lehman rothers Inc. Or one, which is how many omen have made it to the top rung of rgan Stanley. And then re's 14—the percentage women who are manag-; directors at large firms, cording to the industry's by group.

On July 12, a promising mber seemed to pop up: 4 million. That's how ch Morgan Stanley agreed pay to settle charges that it ied promotions and pay reases to hundreds of men. It's the biggest such ard obtained by the Equal ployment Opportunity mmission since 1997, en it won $81 million m Publix Super Markets c. of Lakeland, Fla. Morgan nley will have an outsider nitoring its progress in moting diversity for three rs. And lead plaintiff Allison K. Schieffelin, who alleged the n fired her for complaining about sex discrimination, pockets 2 million to resolve all of her claims.

SMALL VICTORY
Lead plaintiff Schieffelin

WALL STREET'S GLASS CEILING

Few women ever make it on to the executive management committees of their firms:

FIRM	PERCENT OF WOMEN ON EMC
J.P. MORGAN	20%
MERRILL LYNCH	13
AVERAGE	12
CITIGROUP	11
GOLDMAN SACHS	8
MORGAN STANLEY	7
BEAR STEARNS	0
LEHMAN BROTHERS	0

Data: Companies

Good deal? Not really. For Wall Street, the amount is chump ange. Worse, critics say, Morgan Stanley's alleged misdeeds w won't be aired in a public trial, leaving many troubling estions raised by the case unanswered. The firm denies that as ever discriminated against women, though it is adopting unch of programs to treat them better. "We are proud of our nmitment to diversity," Chairman and CEO Philip J. Purcell d in a statement.

Vall Street still needs a big push if women are to get a fair shake. Sure, there has been progress. But despite firms' efforts to improve women's career prospects, there's a long way to go. "Some women don't stay around because they say, 'I'm never going to make it to the top,'" says Muriel F. Siebert, chairman of Muriel Siebert & Co. and the first woman to have her own seat on the New York Stock Exchange.

It is difficult for women to get attention unless they can inflict damage on Wall Street firms where it counts: on the bottom line. The Morgan Stanley settlement is a mere rounding error in its $1 billion quarterly earnings. "It's virtually impossible to get [a settlement] that would hurt these companies," says Chicago lawyer Mary Stowell of Stowell & Friedman Ltd. Her firm filed a landmark 1996 sex-discrimination class action against Smith Barney that resulted, two years later, in a wide-ranging settlement with the firm, now merged into Citigroup.

There's a chance that many women involved in the case could end up with precious little. After Schieffelin's $12 million payday and $2 million to fund new diversity programs, there's just $40 million left for 340 potential claimants—about $100,000 each. The EEOC estimates that only one-third of them will actually file, which would leave each person $400,000. Still, for many bankers, "that's less than a year's pay," says veteran Wall Street compensation consultant Alan Johnson of Johnson Associates. And for many, that's not enough for them to risk ruining their careers by being branded as troublemakers.

To make it on Wall Street, what women really need is commitment from the top. And if CEOs don't show it, directors need to step in. Boards can—and should—make sure the paychecks of the Street's chiefs reflect any failure to treat women equally. Even without going to trial, the Morgan Stanley case raised enough awkward questions for directors to sit up and take notice. "I hope that when the boards of major firms go into their next meeting, they will ask to see how well women are doing," says Siebert. "Numbers speak louder than words." They sure do. And right now, they're screaming for improvement. ■

Personal Business Retirement Guid

No Need to Hit The Panic Button

re, saving for retirement seems daunting. But follow a few basics, and you'll ve enough cash to bring your dreams to life. **BY CHRISTOPHER FARRELL**

BABY BOOMERS ARE SEEN as spendthrifts, credit-card addicts unable to deny themselves any pleasure, blithely ignoring the need to save for old age. "The boomer culture doesn't lead to saving for retirement," says Ann A. Fishman, president of New Orleans-based Generational Targeted Marketing. ¶ The vision of an aging group of 76 million head- toward financial catastrophe is deeply disturbing. Yet it could ll be wrong. An impressive body of economic research paints far more benign picture of the graying generation that es up more than a quarter of the . population. Many of those who ed at Woodstock 35 years ago have umulated more real wealth and earn e real income than their parents did at mparable age. Boomers are also sav- at roughly the same rate as their par- , suggesting they'll have more to tap r saying goodbye to their workmates. generation is also expected to inher- least $10.4 trillion, though most of money will be highly skewed toward rich.

for those who come up short in their geting, working even a few years past traditional retirement age can dramatically boost a household's bottom line. A projected shortage of younger workers over the next two decades means that sixtysomethings should be welcome in the labor force. "There is no need to live in fear that you are going to be penniless in retirement," says Meir Statman, finance professor at Santa Clara University in Santa Clara, Calif.

If that's the case, why is it that conversations about retirement at work and neighborhood barbecues so often turn into litanies of woe and dark humor? Certainly, some segments of society are vul-

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nerable, such as poorly educated, low-skill workers. Concerns persist about the long-term financial stability of Social Security and Medicare. But for most people, from the worker on the factory floor to the professional with a corner office, the apprehension stems largely from not knowing how much is enough to fund a lifestyle, let alone medical bills. Feeding those worries is the financial-services industry, which in large part is designed to lure your retirement dollars. The Wall Street marketing machine is adept at boosting its bottom line by stoking concerns about poor saving habits.

CREATIVITY CONQUERS ALL

YET MOST PEOPLE should find themselves with room for maneuvering later in life. All they need to do is follow some basic savings strategies and take a broad perspective on investment, including building skills employers value. Most important, by carefully thinking through "What really matters to me?" future retirees will devise sensible answers to the question of how much is enough. "People are very creative at coming up with solutions that work for them," says Ralph Warner, author of *Get A Life: You Don't Need a Million to Retire Well.*

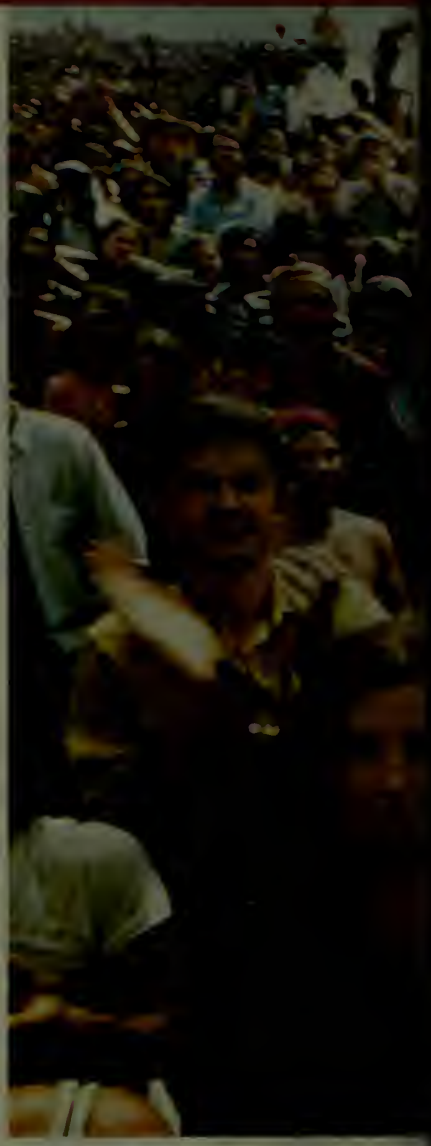
In the 2004 edition of *BusinessWeek*'s Retirement Guide, we'll help you organize your thinking about your next stage in life (page 88) and develop strategies to make it happen. We'll show you how to know whether your nest egg will be adequate (page 82) and introduce you to mutual funds that can help you accumulate it (page 86). If you would like some new environs for your next stage, we'll suggest some intriguing places (page 92).

The standard yardstick for retirement is that households need to generate around 80% of their preretirement income to maintain their standard of living. In a study by John Karl Scholz and Anath Seshadri, economists at the University of Wisconsin, and Surachai Khitatrakun of ERS Group, an economic consulting firm based in Tallahassee, Fla., 80% of households were found to be saving enough. The latest studies on retirement preparedness take a broad measure of wealth, incorporating homeownership, projected Social Security income, pensions, and nonretirement savings, for example, as well as the impact of financial setbacks such as an unexpected illness, a job loss, or a divorce.

Similarly, Barbara Butrica and Cori Uccello of the Urban Institute forecast that current retirees (those born 1926-1935) should have a median wealth of $448,000 at age 67, measured in 2003 dollars. That compares with a projected $520,000 for near-retirees (born 1936-1945), $589,000 for early boomers (born 1946-1955), and $609,000 for late boomers (born 1956-1965).

Not surprisingly, the well-heeled households are doing much better. The wealthiest 20% of current retirees, near-retirees, and early boomers can count on about 127% of their preretirement income in their golden years. The late boomers should have retirement income that's about 117% of their working years' income.

Those who regularly set aside money in retirement accounts are emerging from the turmoil of recent years in reasonable financial health.



Workers' nest eggs did better than stock market, according to the Empl Benefit Research Institute/Investm Company Institute 401(k) database. database includes 15.5 million ac 401(k) plan participants in more t 46,000 plans with $619 billion in as as of 2002 (latest available data). F yearend 1999 to yearend 2002, the v of the 401(k) plans of workers in t 50s dropped by 15%. That comp with a 38% plunge in the benchm Standard & Poor's 500-stock index. since the S&P has delivered a 25% t return since then, those accounts sh be in even better shape.

One factor shoring up portfolios the flow of new money into 401(k)s every paycheck. Equally important that employees have also craf well-diversified portfolios with 62% the money invested in equities and the mainder parked in fixed-income sec ties. Diversification pays.

The sizzling home market has bee boon to household wealth, too. Med home prices have surged some 32% fr

HOW WORKING LONGER BUILDS YOUR STASH

A 46-year-old executive earns $190,000 a year and would like to have at least $150,000 in annual income (in current dollars) with which to retire. These are his financial assets:

401(K) ACCOUNT	$406,000
BROKERAGE ACCOUNT	191,000

He contributes 13% of salary to his 401(k), and his employer kicks in another 6%. He adds $10,000 a year to his brokerage account.

With an expected annual return of 6.1%, here are what his assets will be worth:

	AGE 60	AGE 65
401(K) ACCOUNT	$1,160,000	$1,630,000
BROKERAGE ACCOUNT	484,000	638,000
TOTAL	$1,644,000	$2,268,000
ESTIMATED ANNUAL INCOME FROM PORTFOLIO*	$115,000	$178,000

Data: [illegible]

WOODSTOCK NATION Contrary to stereotype, the boomers are saving plenty

first quarter of 1999 to the same peri- this year. The long-term outlook for dential real estate plays a critical role udging the adequacy of retirement ngs. For example, Scholz, Seshadri, Khitatrakun estimate that the 80% of seholds who are doing well shrinks to 6 when the scholars include only half ome equity. That suggests a genera- 's retirement prospects could sour if e prices crash.

RKING LONGER

LL, THE FEAR of a collapse in residen- real estate seems overblown. The ngest single predictor of the direction home prices is household income growth, and in 42 states that growth explains all the price increases in housing of recent years, says Karl E. Case, economist at Wellesley College. The spectacular price spiral that dominates the headlines is confined to eight states, including Massachusetts, New York, New Jersey, California, and Florida. Markets in those states risk a plunge in prices, he adds, but everywhere else prices are more likely to simply stall for a considerable period. Overall, taking into account long-term forecasts of income growth, the housing market should appreciate at a 4% annual rate, or 2% after adjusting for inflation, figures Mark Zandi, chief economist at Economy.com.

But what if savings are less than hoped for, maybe from a lifetime of bad habits, bad luck, or bad timing? For many people the answer to any deficit is, "Yes, I will work longer," says Laura Tarbox, president of Tarbox Equity, a financial planning firm in Newport Beach, Calif. Smart move, since the impact of earning a paycheck into the traditional retirement years is financially dramatic. The main reason is that an investment portfolio has more time in which to grow before you start drawing on it. The idea of working in their golden years is attractive to boomers, too. According to the latest baby boomer retirement survey by the AARP, 80% of respondents said they expect to be gainfully employed full- or part-time, or even start their own business, late in life (table).

In the Information Age, work should be less of a physical burden, especially with the population better-educated and healthier than previous generations. And demographic pressures should encourage employers to welcome older employees. Anthony Carnevale, a job expert at Educational Testing Service, predicts a skilled labor shortage of some 5 million in 2010 and 14 million by 2020. "Many of my clients expected to work part-time in retirement," says Marc Collier, a certified financial planner at Wellesley Financial Architects in Wellesley, Mass. "They've been surprised at how much they are in demand for consulting work."

Working longer can give a retirement plan a powerful boost (table, page 78). Take an executive who's 46 today, with nearly $600,000 in retirement and nonretirement accounts. At age 60 with more than $1.6 million, he would be able to take out $115,000 a year (in constant dollars) from his portfolio, according to Financial Engines, a Web-based financial planning firm. Staying on the job until age 65, though, could boost his take by more than 50%, to $178,000.

Earning money in retirement certainly works for Fred Henry. By the early 1990s, he had worked for Bechtel

ANY BOOMERS PLAN TO WORK IN RETIREMENT

0% want to work. ere's what they plan do:

: AARP

30%	25%	15%	7%	3%
Working part-time for interest or enjoyment	Working part-time for income	Starting own business	Working full-time in new job or career	Other

Corp. for three decades, lately as a project manager in the power plant business—and he was itching for a change. When he read a magazine article about a financial planner, he knew immediately what he wanted to do. He enrolled in financial planning courses at University of California at Los Angeles, left Bechtel, and earned a number of critical licenses and certificates in the financial-services business. Now 68, he works full-time as a certified financial planner in Torrance, Calif. Says Henry: "I wanted to get out of corporate life, and do something I'm interested in, and be independent."

While the overall trend in retirement savings is positive and work provides a crucial safety valve, how does anyone figure how they're doing right now? Are you putting enough into retirement savings? Do you have too much in stocks or too little? What if you only started saving in your fifties? The short answer is there is no magic number, no infallible rule of thumb that solves the retirement savings equation.

THE GOOD LIFE

BUT THERE ARE good strategies. Start asking yourself what kind of life do you want to lead? What do you want to do? Do you intend to stay in your community, or do you dream about moving to another state or county? Is traveling the world your vision of the good life, or is it making a career shift? Later you can total your 401(k) statements, mutual-fund quarterly reports, mortgage payment schedules, savings simulations, and other financial figures.

Most people find that in the end, their vision of a good retirement is a variation on the life they've lived and the activities they've enjoyed all these years. "If you're given to T-shirts and blue jeans, you won't want to hang out at the country club," says Ross Levin, president of Accredited Investors, a financial planning firm in Edina, Minn. Adds Carl Goodin, a certified financial planner at Financial Planning Associates Inc. in Chesterfield, Mo.: "I have clients who have planned and retired comfortably on an amount of money that, for another client, would hardly pay the country club dues."

The basic financial planning guidelines kick in once you have developed a lifestyle road map. Own your home. Keep debt under control. Fund your 401(k) or similar retirement savings plan to the maximum and, assuming you meet the income requirements, an individual retirement account. The new law

The three keys to financial planning: Diversify, diversify, and diversify

that put a lid of 15 taxes on dividend ments is a powerf centive to establ taxable account for term savings, too. don't get anything than this," says Ch pher Wolfe, man director and global of equities for JPM Private Bank. "I quality companies, dend payers, are an efficient way to for retirement."

The mantra of financial planning versify, diversify, and diversify. The egy of spreading money among st bonds, international securities, cash other assets limits downside risk. investors are adding to their port securities that safeguard against tion, since rising prices erode the va a dollar. The U.S. Treasury sells two income securities specifically desig compensate holders for inflatio measured by the consumer price i One is the Treasury Inflation-Prot Security, better known as TIPS. The is a kind of savings bond, called I-b Neither will produce dazzling ret but they guarantee your capital wi be lost to inflation.

Managing money well is impo But for many people the most impo investment they can make during working years is in gathering the s education, and contacts they need f work they want to do in retirement. even though there are legitimate cerns about the financing of Social S rity and Medicare in coming dec most economists agree the elderly rely on both safety nets being the help out. Higher productivity gr will make paying the bill easier tha ticipated only a few years ago.

Most Americans can afford to g old. Along the way, individuals wi forced to make adjustments to portf savings strategies, and expectat Lots of things can go wrong, too. S retirees will face enormous fina hardship from a lack of money health, or both. But for the vast maj of society, old age is simply ano stage of life with its own challe and rewards. ■

A RETIREMENT CHECKLIST

- ☑ **CONTRIBUTE** to your 401(k), 403(b), or other employer-sponsored savings plan to the legal maximum of $13,000 for 2004 ($16,000 if you're 50 or older). Depending on your income, you may also qualify to stash an additional $3,000 into an individual retirement plan ($3,500 if you're age 50 or older).
- ☑ **DIVERSIFY** your investments. Think beyond a mix of stocks, bonds, and cash. Real estate, gold, and commodities can also play a role in a diversified portfolio. The government's inflation-indexed securities will hedge against the ravages of rising prices, always a concern for retirees. Keep an eye on fees.
- ☑ **INVEST** in equities in taxable accounts, since the maximum federal tax rate on both dividends and capital gains is just 15%. Brand-name companies are hiking their payouts. Reinvesting the dividends in new shares allows your money to compound.
- ☑ **THINK** about the skills, education, and networks you'll need to stay active in the latter stage of life. One strategy is to take advantage of employer programs for work-related education. Another is to take classes at one of the nation's 1,600 community colleges.
- ☑ **ESTIMATE** what your finances will be in retirement. Avoid taking on big debts. You can always slash discretionary expenses—travel, entertainment, and even clothing—if you need to husband cash temporarily.

BusinessWeek online Christopher Farrel examines why rising longevity is good for economy in his Sound Money column at www.businessweek.com/magazine/extra

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Making Your Money Last Over the Years

Nest eggs now have to be bigger as life expectancy lengthens. **BY ELLEN HOFFMAN**

FINANCIAL PLANNERS ALL tell a version of the same story. A moderately prosperous couple, not quite retirement-age empty-nesters, wants to leave the workaday world. Do we have enough money, they ask, to see us through our senior years?

That depends on the comforts and lifestyle they want, the planners say, and on just how long they'll live in retirement—which, of course, no one can know. Most folks understand that those huge stock market gains are history and have tempered their expectations. What clients don't often realize is that life expectancy has even a greater impact on the adequacy of a nest egg. In planning today, it's prudent to assume that a healthy 60-year-old will make it to 90 or even 95. The money that seemed sure to see someone to 80 or 85 then falls short. The inescapable conclusion: The price we pay for living longer is working longer.

Take John and Linda Porter, a fictitious couple who want to retire a year from now, when he's 60 and she's 59. They have a combined annual income of $200,000, money in 401(k)s, individual retirement accounts, and a taxable investment account. We also assumed they would make $500,000 in tax-free profit by selling their house. (Federal tax law provides a $250,000 capital gains exclusion per person when you sell a house in which you've lived for two of the past five years.) They plan to move into a retirement home in North Carolina that they own and on which they still have a $100,000 mortgage. Depending on whether they pay off the mortgage, their nest egg comes to a not-too-shabby $1.3 million if they don't—or $1.2 million if they do (table, below).

We asked four financial planners to assess the Porters' prospects. Their answer: The Porters could count on annual income of $60,000 to $90,000 in current dollars, indexed 2.5% to 3% for inflation, for up to 37 years of retirement. That amounts to 33% to 45% of their pre-retirement earnings, far short of the 70% to 100% planners say is needed to maintain your pre-retirement lifestyle.

The differences in income estimates depend on many factors, only some of which the Porters can control. The couple has made two decisions: when to working and where to live. Other con lable factors, on which the planners erally agreed, were that they should taking Social Security as early as poss when each turns 62, and should pa the mortgage on their retirement h

CAN THE PORTERS RETIRE EARLY?

John and Linda Porter, a fictitious couple, would like to take an early retirement starting July 1, 2005, when John will be 60 and Linda, 59

ANNUAL HOUSEHOLD INCOME $200,000

TOTAL 401(K) BALANCE(S) $500,000 (50% each)

TOTAL ROTH IRA BALANCE(S) $100,000 (50% each)

TAXABLE INVESTMENT ACCOUNT $200,000

EXPECTED PROFIT FROM SALE OF PRINCIPAL HOME $500,000

RETIREMENT HOME Owe $100,000 mortgage on house in North Carolina, monthly payments of $568

» FINANCIAL PLANNERS S

- Start taking Social Security at age 6
- Budget $600-to-$800 per month fo health insurance until eligible for Medi
- Pay off mortgage on the retirement
- Allocate investments 50/50 stocks or 60/40
- Assume an inflation rate of 3%
- Withdraw 4%-5% annually from tot
- Expect an annual income that can r $60,000 (before Social Security) to $

ILLUSTRATION BY TIM LANE

STRETCH OUT THOSE DOLLARS

First, estimate your expenses in retirement, and from that, subtract what regular income you'll get from Social Security, pensions, and other annuity-like sources. The difference is your income shortfall. Total all your savings and investments in IRAs, 401(k)s, and taxable accounts. Remember to include the cash you expect to pocket if you sell your home. Divide the shortfall by your total investments. Multiply that by 100 to get the withdrawal rate.

Suppose your income shortfall is $80,000 a year, and your total savings is $2 million. Divide the $80,000 by $2 million and multiply by 100. That gives you a 4% withdrawal rate. If you're money earns an average of 5%, which could be done with a conservative mix of stocks and bonds, the nest egg should last 33 years—and these calculations include a 3% a year increase in income to allow for inflation.

WITHDRAWAL RATE	RATE OF RETURN											
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	11%	12%
12%	7	8	8	8	8	9	9	10	10	11	12	13
11	8	8	9	9	9	10	10	11	12	13	14	15
10	9	9	10	10	10	11	12	13	14	15	17	19
9	10	10	11	11	12	13	14	15	16	18	21	26
8	11	11	12	13	14	15	16	18	20	24	30	*
7	12	13	14	15	16	18	20	22	27	36	*	*
6	14	15	16	18	19	22	25	31	44	*	*	*
5	17	18	20	22	24	29	36	*	*	*	*	*
4	20	22	25	28	33	42	*	*	*	*	*	*
3	25	28	33	39	*	*	*	*	*	*	*	*
2	35	40	50	*	*	*	*	*	*	*	*	*
1	*	*	*	*	*	*	*	*	*	*	*	*

*More than 50 years

Data: Deena Katz, *Taking Charge of Your Retirement*

e Social Security benefit—indexed an-
ally for inflation—will account for
5,200 of their income if John starts at
and an additional $10,800 from Linda
ear later. That's 25% less than each
uld receive by waiting until their full
irement age of 66. But, says Jean Sinclair, a planner in La Jolla, Calif., if the Potters did wait until 66 to receive Social Security, it would take them 12 years to reach the "breakeven point" when they would make up for the Social Security income lost between ages 62 and 66.

Three of the four planners recommended that the Porters use $100,000 of the house-sale profit to pay off the mortgage on the retirement home. The rationale: The value of the tax deduction on the mortgage interest would wane as their income falls and those monthly payments are increasingly devoted to principal.

BIG BITE

BESIDES SOCIAL SECURITY, the Porters' only other income will come from their investments. The advisers suggested rolling the 401(k) money into a traditional IRA (with no tax consequences) because it gives them more control and investment options. They also recommended putting the remaining $400,000 from their house sale into their taxable investment account.

Early retirement takes a big bite out of anyone's capital. Social Security won't kick in for a few years, and Medicare doesn't begin until they turn 65. That means the Porters might have to cover $600 to $800 a month in medical insurance for five or six years. People who wait until they get Medicare before retiring might not have such high costs.

So how long will the money last? Suppose the Porters' portfolio earns a 7% average annual rate of return. At a 7% withdrawal rate, it will last 20 years, according to a table used by Deena Katz, a financial planner in Coral Gables (Fla.). Drop the withdrawal rate to 6%, and the money should last 25 years, and at 5%, 36 years.

All these figures can differ significantly depending on the planners' assumptions. Steve Merkel, a financial planner in Coconut Grove, Fla., figured on 2% inflation, not 3%. So even with a 5% withdrawal rate and a 4% return on assets, he figures that in 35 years, when John turns 95, the couple would still have nearly $749,000 in their account. That would still be roughly $375,000 in current dollars, assuming a 2% inflation rate.

All of the advisers recommended the Porters allocate 60% of the portfolio to stocks and 40% to bonds or divide the portfolio evenly between stocks and bonds. To minimize risk, they suggested investing in mutual funds and creating a "laddered" bond portfolio—a strategy of buying short-term bonds that mature in 1, 2, 3, 4, and 5 years, reinvesting the proceeds in the five-year bonds as each group matures. None of the counselors thought buying a fixed-income annuity now was a good idea. Harry Scheyer, a planner in Marlton, N.J., said interest rates are too low to lock in a long-term investment,

AYS TO BOOST INCOME

- k full-time for a few more years
- part-time job while in retirement
- 2 or older, get a reverse mortgage on tirement home
- pone Social Security benefit, at least ull retirement at age 66
- ew IRA withdrawal rates annually to ize taxes

even one that offers an inflation adjustment. He suggested the Porters reconsider an annuity in 10 years, when their lifestyle is more settled and their needs more predictable.

TAX STRATEGIES

THE PORTERS CAN improve their situation with some savvy tax planning, too. Guy Holman, a financial planner in Denver, suggests the couple vary the asset allocation within the different accounts. He recommends that they invest both their taxable account and their Roth IRA funds 100% in stocks. Holman also says the taxable account should be managed to generate long-term gains, which will be taxed at just 5% if the Porters can keep their taxable income to the 15% marginal tax bracket and 15% if their income is higher. The gains in the Roth IRA won't be taxed because the Porters already paid tax on the money. Holman would invest funds in a traditional IRA —which is taxed as income when withdrawn—of 80% fixed-income securities and 20% stocks.

Retirees must review their financial plans yearly

Making your money last depends mostly on devising a financial plan and sticking to it, reviewing the plan at least once a year, and correcting it when necessary. Katz suggests retirees withdraw a little less than what they think they'll earn, such as taking 6% if you're making 7%. That provides some buffer against a turndown in the market.

Can the Porters plan on retiring in 12 months? Sure, if they're willing to live on $60,000 at first. But Scheyer says the best strategy for the Porters would be to make an up-front "adjustment" by continuing to work for a few more years. That would allow them to keep their employer health insurance, put more money aside, and possibly boost their future Social Security benefits.

It's probably not what they want to hear. But the strategy would give them a better shot at cushier golden years. ■

BusinessWeek online Ellen Hoffman analyzes Health Savings Accounts in her Your Retirement column at businessweek.com/magazine/extra.htm

Q&A

How to Dodge IRA Pitfalls

Ed Slott talks tactics in taking distributions

FOR YEARS, YOU'VE BEEN stashing money in 401(k)s and in vidual retirement accounts. But soon after you turn 70½, Internal Revenue Service requires you to start taking it o The rules are complex, and penalties can be stiff. To h you avoid costly mistakes, Personal Finance Editor An Tergesen spoke with IRA expert Ed Slott.

What are some common mistakes?
For most people, the date you're required to begin taking withdrawals is Apr. 1 of the year following the year in which you turn 70½. So if you turn 70½ this year, the IRS gives you until Apr. 1 of 2005 to start. But it's a mistake to wait, because you'll have to take two distributions in 2005—one covering your first year of required distributions and the other covering your second. It's better to take your first distribution in 2004. That way you separate the distributions into two tax years and generally lower your income—and your tax bill—in each year.

Can you delay distributions if you're still working at 70½?
You don't have to take distributions from your employer's 401(k) plan. But when it comes to IRAs and 401(k)s from past employers, you can't escape.

If you have several accounts, do you have to take withdrawals from each?
If you have more than one IRA, add their balances. You can take a distribution from one account that covers all of them. Be careful not to mix 401(k)s and IRAs this way, though, since the rules require you to take money from each. Likewise, a married couple can't take money out of one spouse's account to cover the other spouse's distribution. And with more than one 401(k), you've got to take separate withdrawals from each.

Are there any problematic investmen
Some people tie all their money u certificates of deposit. As a result, t have to break into a CD early just to t their distribution and incur a penalty

Anything else we should know?
You don't have to take distribution cash. Say your required distributio $10,000. If you own IBM stock in y IRA but want to hang on to it, you transfer shares worth $10,000 to a t able account and pay income tax o But when you sell the stock, remem that you already paid this tax, or might accidentally pay the IRS twice.

BusinessWeek online For an extended version of the Ed Slott interview, go to www.businessweek.com/magazine/extra.

IBM Workplace	Key
1. Sees stock devaluation immediately. 2. Updates clients' apps automatically. 3. Accesses updated trading app instantly. 4. Reviews pundit predictions easily. 5. Buys stock in a snap.	**MIDDLEWARE IS IBM SOFTWARE.** A powerful, collaborative environment like IBM Workplace that provides access to people, processes and information on one open, dynamic platform. It's how you access everything from content to applications to global partners for faster, more informed decision making. It's how productivity increases. And it's big news for your business. That's ON DEMAND BUSINESS.

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ILLUSTRATION BY TIM LANE

Funds That Adjust As the Years Go By

Lifecycle funds do the timely asset reallocations that you mean to do but often don't. **BY LAUREN YOUNG**

YOU CHECK YOUR 401(K) and IRA balances at least once a month and fine-tune allocations among funds depending on changing market conditions, which you monitor closely. You study shareholder reports and give serious thought to fund managers' commentaries. You have a long-range strategy that gradually shifts the overall mix from riskier equities to more stable fixed-income investments as you approach retirement age.

Are you that sort of investor? Probably not. Study after study shows that most people fail to properly monitor, diversify, and rebalance their portfolios. Sure, with a hefty six-figure account you could hire someone to do all that for you—and pay that person 1% or 2% a year or more. But if you're younger, with a lower balance—or you'd rather keep that fee yourself—there is an alternative: a breed of mutual funds called "lifecycle" funds.

What distinguishes these from other asset-allocation funds is that they rebalance—going from heavy commitments in stocks to greater allocation in bonds—as their shareholders move toward retirement. In other words, these funds do all the things you say you are going to do but don't. "These are cruise-control funds," says Daniel Wiener, editor of the newsletter *Adviser for Vanguard In*

Lifecycle, or target-maturity, could be the only investment d you ever need to make. You ch fund with a maturity date close t expected retirement and just putting money in there year after 35-year-old might choose Fidelit dom 2040, which is specifically m for investors who plan to retire that time.

This all-in-one approach is lifecycle portfolios one of the best- mutual-fund products. Assets 68% this year, to more than $32 according to Boston-based Financ search. There are 223 target-m funds offered by such companies delity Investments, T. Rowe Price, Vanguard Group. Few of these fun long records, but the returns the earned are certainly competitive the fund universe and against th market as a whole.

In a 401(k) or similar plan, you'r ty much stuck with the target-m funds that your employer selects. IRA that you control, you can choos you like best. And though most of funds are in tax-advantaged plans, nothing to stop you from using th general investment purposes. Alt the overall idea behind lifecycle fu the same, the asset-allocation st and investment styles do vary. course, do fees.

Here are some important issues t sider before you invest:

ASSET ALLOCATION

WHAT'S THE RIGHT mix of stocks, and cash? "For all the millions of spent on the topic of asset allocatio get answers all over the map as to wh ideal asset allocation should be," say Rekenthaler, president of Mornin the Chicago fund tracker.

T. Rowe Price, for instance, tilts m ward equities than than some of its Look at the T. Rowe Price Retirement Fund, some of whose shareholders already be retired. About 62% of the are in T. Rowe Price equity funds 29% in fixed income and 10% in cash folios. (This adds up to more than due to rounding.) In contrast, just 3 the Vanguard Target Retirement fund is invested in stock funds, with t mainder in bond offerings. Jerome

BusinessWeek online For more on how these funds invest your money, visit www.businessweek.com/magazine/extr

BEATING THE MARKET

/SYMBOL	AVERAGE ANNUAL TOTAL RETURN*
ys LifePath 2010 STLBX	2.39%
ity Freedom 2010 FFFCX	2.96
der Target 2010 KRFAX	4.25
clays LifePath 2020 STLCX	1.47
ity Freedom 2020 FFFDX	1.91
s Fargo Outlook 2020 A STTRX	0.67
clays LifePath 2030 STLDX	0.76
elity Freedom 2030 FFFEX	1.05
cipal Investors LifeTime 2030 PTCSX	4.36
clays LifePath 2040 STLEX	-0.01
elity Freedom 2040 FFFFX	0.30
stEgg 2040 NEFYX	0.36
mutual funds average	1.99
ndard & Poor's 500	-1.02

reciation plus reinvestment of dividends and tal gains before taxes Three years ended July 12 **Data:** Morningstar

runs T. Rowe's retirement portfolios, today's seniors may live 30 years in re- nent, so they need to avoid the trap of ing too conservative with their portfo- too soon. "What might seem like a lent investment approach might actu- prove more risky in the long run," k says. In fact, T. Rowe's retirement ls with later maturity dates, including 0, 2035, and 2030, hold as much as of their portfolios in equities. Fidelity dom funds with the same maturity s have slightly smaller allocations to ties (chart).

you select the target-maturity fund in r retirement plan, be careful not to other funds to the mix unless you are ing true diversifiers such as real estate ommodities that the lifecycle funds t already own. Otherwise, you'll skew asset-allocation plan.

OLDINGS

U NEED TO CONSIDER how the fund lements its strategy. More often than you'll find that the investments with- fecycle funds are other funds offered he sponsoring fund family. That's cer- ly the case with the Fidelity Freedom ds, which hold as many as 19 Fidelity folios. Chances are you won't even e that many options in your retire- t account.

Not surprisingly, Fidelity's target-maturity funds are well-diversified among actively managed funds, since that is Fidelity's speciality. Just look at Fidelity Freedom 2040. It holds five international funds, including Fidelity Japan, Fidelity Southeast Asia, and Fidelity Europe. Some of the fund's other holdings include Fidelity Mid-Cap Stock, Fidelity Blue Chip Growth, and Fidelity Investment Grade Bond.

Barclays LifePath funds aren't nearly as complex. The typical portfolio mainly sticks to five index funds. Vanguard's Target Retirement funds are even more basic, often using just four index funds: Vanguard Total Bond Market, Vanguard Total Stock Market, Vanguard Pacific Stock, and Vanguard European Stock.

Different from the fund-of-funds approach are the Wells Fargo Outlook Funds. They invest directly in stocks and bonds rather than mutual funds. Top holdings in the Wells Fargo Outlook 2040 Fund include much of what you would get in an index fund: Microsoft, Pfizer, Citigroup, and General Electric.

» EXPENSES

COSTS FOR TARGET-MATURITY funds vary widely. AIG SunAmerica, for instance, recently launched a new series called High Watermark Funds. What makes them intriguing is that investors are guaranteed the highest net asset value attained during the life of the fund if they hold shares to maturity. But that feature comes at a high price. The fund's 1.65% expense ratio is above the average 1.31% for the typical moderate-allocation fund. There's also a good chance that you'll have to pay a sales charge of as much as 5.75% to invest in one of these funds.

In contrast, expense ratios for the Fidelity Freedom funds, which are the most popular of the bunch, with a combined $25 billion in assets, range from 0.70% to 0.94% of assets. That includes a standard management fee of 0.10% for the asset-allocation service. Vanguard's Target Retirement funds are even cheaper, with an expense ratio of about 0.20%. If you're searching for another low-cost option, TIAA-CREF is expected to roll out seven target-retirement funds later this year.

Strategies and fees vary, so it's worth taking the time to compare

» PERFORMANCE

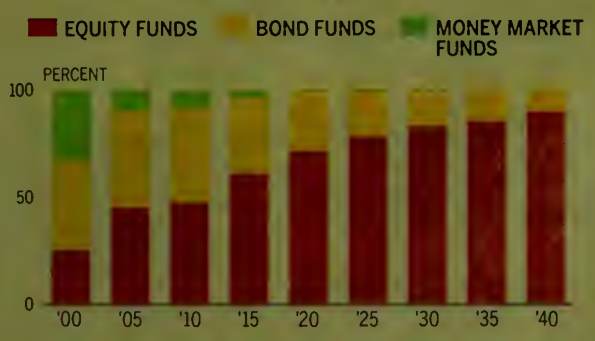
BECAUSE TARGET-MATURITY funds are relatively new—only nine portfolios have a 10-year track record—there's limited data available to judge their success. Even so, their performance as a group looks pretty good. Five of those funds beat their Morningstar peers, including conservative- and moderate-allocation and large-blend funds, while the other four came within a percentage point.

One standout is the Scudder Target 2010 fund, which gained an average annual total return of 9.78% for the 10 years ended on June 30, while the typical conservative allocation fund rose an average of 7.54%.

For investors with long time horizons—but not much time on their hands—the all-in-one convenience of lifecycle funds is right on target. ■

HOW LIFECYCLE FUNDS INVEST YOUR MONEY

With these sorts of funds, investors choose a portfolio that's closest to their planned retirement date. The longest-dated portfolios have the most equities, and this changes over time as the retirement date nears. Here's an example using Fidelity's Freedom Fund series.



Data: Fidelity Investments

CHART BY ROGER KENNY

Getting Psyched To Retire

A financial plan isn't enough. You'll need to be ready emotionally as well. **BY TODDI GUTNER**

IF YOU THOUGHT NOTHING would ever compare with the turmoil of adolescence, you may be in for a big surprise. A similar period of self-searching and emotional change hits people on the cusp of retirement. Ken Dychtwald, a psychologist, gerontologist, and author of *Age Power: How the 21st Century will be Ruled by the New Old*, calls it "middlescence."

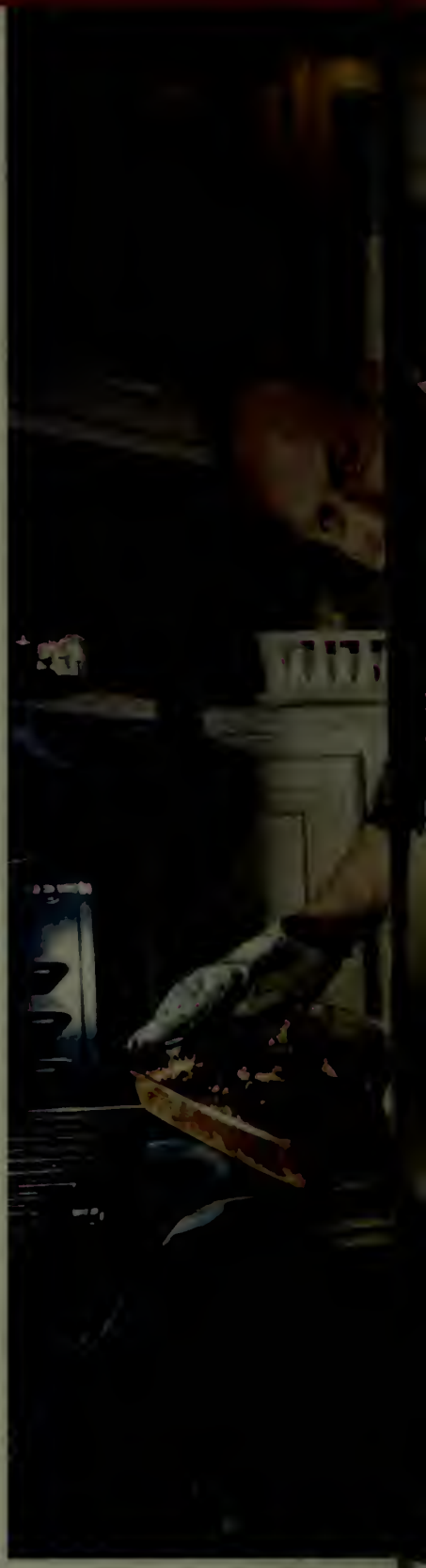
This time in one's life, from the early 50s and beyond leading up to retirement, can be fraught with uncertainty, anxiety, and even depression if you're not prepared for it. "Psychological security in retirement is just as important as financial security," says Sara Yogev, a Chicago psychologist and author of *For Better or For Worse...But Not For Lunch: Making Marriage Work in Retirement*. "Still, so many people fail to prepare and plan" for the psychological component.

Think about what work does for you, and you begin to understand why retiring can leave you so unsettled. Work structures your time, can be a source of intellectual stimulation, provides social contacts, gives you an identity, and builds your self-esteem. In our society, you are what you do. Stop doing it, and you can lose your sense of yourself. For some people, a steady diet of leisure activities can fill the void. But for many others, the initial euphoria of having all that free time can quickly turn into boredom or despair.

That's what happened to Bernard Salevitz. Five years ago, at 65, he left a thriving urology practice in New York and moved with his wife, Carolyn, to Scottsdale, Ariz., where they had built a second home and one of their two children lived. After three months, "I mentally and physically collapsed," Salevitz says. While he thought he'd just play golf and travel, "there was no challenge or stimulation in my life, and that was a big mistake." What saved him was returning to work at the Mayo Clinic in Scottsdale, where he teaches residents and sees patients three days a week. "It brought me back to civilization," he says.

Salevitz was lucky in that, as a physician, he had highly marketable skills and could land a job quickly. But you really don't want to wait until a crisis hits to figure out what you want to do. You need to start thinking and preparing for this next phase of your life well in advance of your actual retirement.

The focus should be on "where can I make the biggest contribution and have the most fun," says Phyllis Moen, a sociologist at the University of Minnesota in Minneapolis who studies retirement issues. Will it be working with the Peace Corps, teaching adult education courses, helping out a nonprofit organization, or serving on advisory boards for fledgling



STAGES OF RETIREMENT

1 PREPARATION

In your early 50s, begin to think about things you enjoy doing and jot them down in a notebook. Focus on what challenges give you mental and personal satisfaction. Make contacts with people who may be able to help you later.

2 CELEBRATION

Decide how to celebrate retirement event as you transition from one phas career-building life to the can throw a party, take that big trip you've dreamed of, or purchase something specia

HELFMAN
Taking steps to teach in graduate and law school

companies? Jot your ideas down in a notebook.

To better prepare for the transition, speak with friends and colleagues who might offer leads or contacts. Talk to people who are already retired. They have firsthand experience with the decisions you're facing and can tell you what they did and how it's working out. Ask what kinds of things surprised them and if they would have done anything differently five years before they retired.

FIVE STAGES

A FRANK DISCUSSION with your spouse is crucial in making the change go more smoothly. You need to decide where you're going to live, how much leisure time to build into your schedule, and—if you both want to travel—whether you'll be sleeping in a Winnebago or the Ritz-Carlton. "Retirement is not a one-time event or an extended vacation," Yogev says. "It's a change of life." In fact, Yogev identifies five stages of retirement: preparation, celebration, honeymoon, reality, and reorientation (table, below).

Seeking the support of a career counselor or therapist who specializes in work transitions might also help. You can ask your human resources office for referrals. This may be especially important if you're a hard-charging professional who has had time for little else other than building a career. You may not have other interests or hobbies to sustain you outside of work.

You can also turn to the dozens of books and Web sites that specialize in retirement. One site, retire2enjoy.com (table, above), has an entire section on the psychology of retirement, complete with four pages of books on the subject. The AARP site, aarp.org, has a good section on careers and community service.

Most people are likely to want to continue working, either in a volunteer position or for pay. If you're interested in staying connected to your company, ask about phased retirement. This is where older employees stay on to assist less experienced workers, sometimes on a part-time or project-by-project basis.

Steve Vernon, a vice-president with benefits consulting firm Watson Wyatt Worldwide, has clients who offer their employees phased retirement, and now Vernon is planning to work out such an arrangement for himself. In about four years—when he's 55 and his youngest child graduates from college—Vernon intends to cut back at Watson Wyatt to three days a week. He would like to use the time he has freed up to get involved with an organization that promotes environmental causes and to speak on a topic that he's currently writing a book about—finding meaningful work in retirement. "I still want to work, but I also want to contribute to society," he says.

Although phased retirement is growing in popularity, you may want to try your hand at something new. Think

Don't wait until you retire to figure out what you want to do with your time

HELP FOR YOUR HEAD

WEB SITE/COMMENTS
aarp.org Advocacy group for the over-50 population offers resources and message boards on finding meaningful volunteer jobs
agewave.com Ken Dychtwald's site highlights interesting articles on the aging of today's labor force and the impact on retirees' lives
kayehealey.com.au Australian-based retirement counselor offers sage advice on surviving the transition into retirement
retire2enjoy.com Comprehensive site with section on the psychology of retirement and a list of books on the subject

3 HONEYMOON

Enjoy the temporary, euphoric feeling that comes from having the time to do what you want to do when t to do it. Realize you will soon tire of found freedom.

4 REALITY

This is when you really understand the profound changes in your life. If you haven't prepared properly, boredom and even depression may set in.

5 REORIENTATION

Create a daily schedule of how you will spend your time. Build new routines of activities that will keep you socially and professionally connected. Figure a six-month period to acclimate to your plan.

PHOTOGRAPH BY DANIEL PEEBLES; CHART ICONS BY RAY VELLA/BW

about skills you learned that are transferable to other jobs. As general counsel of BMW of North America, Dennis Helfman has become an expert in automotive regulation and German law. He has also enjoyed lecturing on these topics at business meetings. Now Helfman, 57, whose company encourages him to retire at age 60, is making plans to teach graduate business and law students. His wife, Alyce, a high school librarian, hopes to land part-time work in a public library.

Although they live in New Jersey, Helfman has been contacting universities in Michigan, where he has a second home, and Florida, where he is likely to spend the winters. He is offering to give guest lectures. "It gives the schools an opportunity to try me out, and I can learn what I need to do to become an adjunct professor," he says.

Despite all his plans, Helfman doesn't just want to work. He's an avid cook and enjoys entertaining. Like Helfman, consider how else you will fill your time think about scaling back your wo hours. Classes? Hobbies? Make su have a well-thought-out daily and w schedule to structure your days.

All this planning may seem dau if you were expecting to coast in tirement. Unless you give se thought now to how you'll fill your you could be facing an emotional that may feel a lot worse than adole angst. ■

Q&A

The Golden Years? Try Go-Go Years

A talk with retirement guru Ken Dychtwald

PEOPLE USED TO WORK for 40 years, then abruptly head out to pasture. Today retirement is a more active pursuit, combining work, self-improvement, and fun, says Ken Dychtwald, cofounder of Age Wave, a San Francisco research firm that focuses on the graying workforce. Dychtwald, 54, is a gerontologist and author of 10 books on aging-related issues. Associate Editor Toddi Gutner caught up with him by phone to explore his views on the new definition of retirement.

How has retirement evolved?

At the beginning of the 20th century there was essentially no retirement. People worked until they died, and they thought it was a good thing. In the 1930s, the Depression saw 25% of the labor force out of work. President Roosevelt decided to make room for the younger generation and created the retirement age of 65.

Retirement over the next several decades meant a short pause before death. But life expectancy increased, the quality of life for retirees improved, and financial well-being rose. In the 1980s and '90s, retirement became an extended period of leisure that was promoted as something infinitely desirable, and something we were all entitled to.

Where are we now?

Today's retirees are social guinea pigs. We're shifting away from the model of learning for 20 years, working like a mad dog for 40, and goofing around for 20. What is evolving is some new blend between learning, working, and leisure.

Retirees are saying: "Just because I'm older doesn't mean I don't have dreams." Take John Glenn Jr., who at 77 went back into space. Or Jack McKeon, the 72-year-old coach, who was called out of retirement and catapulted the Florida Marlins to a World Series victory.

What is "middlescence," as you put it in your book *Age Power*?

It is the period between your 50s and 70s when you have to find a new identity. While disorienting and confusing, there is tremendous opportunity. Rather than winding down, retirees are reinventing themselves. Rather than wandering off to society's sidelines, they're having fun and embarking on new careers. It's not the end of life but really just the third qua

How can business develop a mutually beneficial relationship with the growin ranks of middlescents?

There are a lot of similarities between women's movement and the age of r dlesence. In both situations, compa need to design jobs that make it more tractive to stay than to leave. A lot of ent and experience gets shoved out door. There are also many obstacle pension and benefits regulation make it difficult to continue to em those in middlesence who may pr more flexible or part-time arrangeme Changes in these policies will be good business, people, and the economy. ■

BusinessWeek online For an extended interview with Dychtwald go to businessweek.com/magazine/extra.htm

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Where To Hang Your Hat Next

Want to go back to school? Stay fit? Play golf? Here are some hot spots. **BY LARRY ARMSTRONG**

SO YOU'RE PLANNING TO RETIRE. But where? No one can pick the best place for you, and we won't even try. It's a complex decision that demands you assess your finances, health, hobbies, and family connections. In the end, most people stay pretty much where they are. ¶ Just in case you're itching for a change, we asked experts to come up with suggestions for some retirement hot spots. They range from what you might expect—communities with access to great golf—to some that might not have occurred to you. Ever considered living on a college campus again? ¶ If you're the active type and see retirement as a way to pursue those interests full time, we look at a few retreats with mountains at hand, from popular Asheville, N.C., to out-of-the-way Sisters, Ore. Or maybe you're still dazzled by the bright lights of the big city, with its wealth of cultural and entertainment opportunities—not to mention your family and lifelong friends. But you'd like some respite from the noise and congestion. We have a few ideas about nearby places where you can live a bit more comfortably.

Hunting for Golf Heaven

Our expert scoured the nation to match up quality of life with quality of links

SANDPIPER Santa Barbara also boasts a balmy climate

NIK WHEELER/CORBIS

HOT SPOTS

WITH THE EXPLOSION IN golf courses over the past 15 years, you would think that finding a golf mecca to retire to would be about as easy as sinking a 6-inch putt. Well, good golf may be everywhere, but even the most dedicated player also desires fine restaurants, high-quality medical care, and a wide variety of cultural pursuits as part of the retirement package.

We asked sports geographer John Rooney Jr. to help narrow the field by matching up quality of life to quality of golf around the country. An emeritus professor of geography at Oklahoma State University, Rooney co-founded market researcher Longitudes Group last year to track the travel and behavior of avid golfers. Rooney happens to have a 7 handicap himself.

He weighted the crime, congestion, cost of living, climate, and culture of the cities equally with the quality, cost of, and access to golf in the region. He picked five metro areas: one for summer golf, two for winter, and two suitable for year-round play. "If golf is a factor in your retirement decision," he says, "chances are you'll want and can afford a summer place and a winter place."

His choice of the best place for summer ultimately became the location of his own summer home: Grand Haven, Mich., in the Grand Rapids/Holland/Muskegon metro area. Besides a dozen courses rated 4.0 or 4.5 stars by *Golf Digest's Best Places to Play* (Fodor's, $22), including Thousand Oaks in Grand Rapids and the Ravines in Saugatuck, the area has dozens of art galleries and museums and a year-round symphony. There's also a lively summer community that congregates around the beaches and yacht clubs along the shores of Lake Michigan.

Scottsdale, Ariz., and Naples, Fla., score the highest for the winter months. The Scottsdale area has 30 or so courses of 4.0 stars or better, from the exclusive Estancia Club at the foot of Pinnacle Peak to the public Troon North Golf Club. For Florida, crime and congestion rule out the vaunted Miami/Fort Lauderdale/Palm Beach golf corridor. A better choice is Naples or Fort Myers on the other side of the state. You'll get the same tropical climate, great sand beaches, and saltwater and freshwater fishing. The golf is equally good or better, Rooney says, and tee times are cheaper and easier to snag.

LIVE AND TEE OFF

PLACE	GOLF PLAY DAYS/YEAR	MEDIAN HOUSE VALUE*
Chapel Hill, N.C.	262	$165,800
Grand Rapids, Mich.	230	111,500
Naples, Fla.	278	202,100
Santa Barbara, Calif.	313	360,000
Scottsdale, Ariz.	295	154,100

*Metro Area Data: Longitudes Group, BestPlaces.net

REASONABLE PRICES

FOR YEAR-ROUND GOLF, Rooney likes Santa Barbara, Calif., and Chapel Hill, N.C. Sure, everyone wants to play Pebble Beach, but only the wealthiest retirees can afford it and surrounding clubs on California's Monterey Peninsula. Santa Barbara and neighboring Ventura County to the south have a more moderate, Mediterranean-like climate coupled with reasonably priced country clubs, and good public golf at such highly ranked ocean view facilities as the city's Sandpiper Golf Course.

The strategy for Chapel Hill and the surrounding Research Triangle area? Base yourself there for the restaurants, big-time college sports, and cultural events. Join a club or use the upscale public courses, and make day jaunts to play the trophy courses at Pinehurst, 90 minutes south, or overnight trips to play the hundreds of courses that line the Carolina and Northern Georgia coast.

In fact, that's the best move for any avid golfers lining up their retirement: Remember that the game is only half of the big picture.

TIBURON Great views, and easy to get into San Francisco

So Near and Yet So Far

These towns are convenient to big cities, yet set you free from urban cares

HOT SPOTS

IT HAS THE CHARM AND salt air of a fishing village, a seaside resort with snug bungalows for the summer folk. But it has grown up into a self-sufficient, year-round community that's ideal if you're looking for a place to retire. Best of all, it's less than an hour by rail to midtown Manhattan. Welcome to Point Lookout, N.Y., a hamlet on the eastern tip of one of the barrier islands off Long Island's South Shore.

Point Lookout offers retirees the rich cultural life, good restaurants, and entertainment options of the big city, without the congestion and crime. In that respect, it shares key attributes with Bradbury, Calif., a tiny village nestled in the foothills of the San Gabriel Mountains northeast of Los Angeles. Or with Belvedere and Tiburon, Calif., neighboring enclaves with million-dollar homes and three yacht clubs, including the San Francisco Yacht Club, the oldest on the West Coast. The peninsula has breathtaking views of San Francisco and the Golden Gate Bridge, and the ferry ride downtown takes just 20 minutes.

BusinessWeek online To find which neighborhoods offer the best value, go to www.businessweek.com/magazine/extra.htm

These places are especially attractive to people who spent their working lives in cities and still have family and friends there. "Three-quarters of all people retire within 50 miles of where they live," says Andrew Schiller, the PhD geographer who runs demographic researcher Location Inc. "They want to be 'going-out-to-dinner' distance away." Schiller has pinpointed the best neighborhoods for seniors within 60 miles of each of the country's biggest cities (table).

To come up with his picks, he looked for low crime rates, places with a high percentage of seniors and college-educated residents, and neighborhoods with established homes, easy walka and an artsy or funky element. Qu health care is a given because of pro ity to the cities. He didn't conside fordability: If value is part of your e tion, you can do your own search a company's Web site, neighborh scout.com.

The places are among the most ex sive and exclusive in their regions. H ington, Md., for example, with its his Victorian-era homes in the Queen and Colonial Revival styles, w planned community developed in 1890s as a respite from the hot sum in Washington. Schiller pinpointed this central village, not the sprawl of homes surrounding it.

SEA GRASS

O.K., SOME OF THE PLACES are a b a stretch for dinner and a play in th city. The desirable lakefront neigh hoods of Michigan City, Ind., have been popular as a summer retrea Chicagoans. The city is next door to 25-mile-long Indiana Dunes Nati Lakeshore, with its mile hiking trails and sand be es, and a commuter rail puts Chicago less than hours away.

Historic Sandwich, M incorporated in 1639, is C Cod quaint with sea g beaches, and a boardwalk seniors, the annual shell ing permit is $5, less th bowl of quahog chowde Boston, 57 miles north. St the city beckons, it's an weekend jaunt. You just l to tear yourself away. ■

STAYING CLOSE TO THE CITY

PLACE	MILES TO CITY CENTER	MEDIAN HOUSE VALUE*
Belvedere/ Tiburon, Calif.	San Francisco, **17**	$1,210,000
Bradbury, Calif.	Los Angeles, **22**	844,232
Kensington, Md.	Washington, D.C., **22**	370,155
Michigan City, Ind.	Chicago, **58**	222,827
Point Lookout, N.Y.	New York, **40**	561,655
Sandwich, Mass.	Boston, **57**	254,573

*For select neighborhoods

Data: Location Inc.

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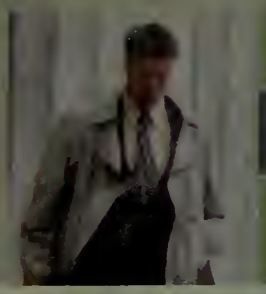

Point of Law

Legal Insights for Business

To read the full report and related information, go to the link listed below or www.point-of-law.

The Shrinking World of Antitrust: Is There Still Hope?

It has been only 32 years since Justice Thurgood Marshall referred to the antitrust laws as the "Magna Carta" of the free enterprise system, assuring the right to compete without artificial restrictions. Unlike the true "Magna Carta," this assurance has been shrinking. A dramatic shift has occurred in antitrust law and in the underlying philosophy that competition really matters.

Significant changes include:

1. Collusive conduct rarely occurs in public and has been traditionally proven by inference based on circumstantial evidence. The range of permissible inferences has been substantially reduced: conspiracy cases have become more difficult to win.

2. While the monopoly provisions of antitrust laws have been broadened, gaps and uncertainties still exist, e.g., predatory pricing has effectively been emasculated as an antitrust claim.

3. Changes have been even more dramatic in the area of litigation procedures. Today, most antitrust cases fail to survive the "antitrust injury" analysis which has been expanded to include a multitude of excuses why plaintiffs should lose.

Having pointed out the pitfalls of an antitrust claim, we must add th have been a significant number of who have been successful. A judg excess of one billion dollars was affi *Conwood Co. v. United States Toba* And there are numerous others. The co is that the Courts have continued to to legitimate claims of antitrust p where there is substantial evidence of si harm to the competitive process. Ea must, therefore, be scrutinized on to assess whether it is likely to fall into gory of "this is a real antitrust case." Bott be realistic but not daunted by the sh world of antitrust.

To read the full report, go to www.point-of-law.com

BLECHER & COLLINS Founded in 1971, Blecher & Collins engages in complex business litigation, with emphasis on antitrust. The firm's tional expertise in the antitrust field has resulted in many precedent-setting decisions in the U.S. Supreme Cou several courts of appeal. Blecher & Collins has had extensive trial experience in federal and state courts on behalf of both plaintiffs and defenda a broad spectrum of domestic and international clients. Contact: Maxwell M. Blecher 213-622-4222 • www.blechercollins.com

Trademark Infringement Defense: Responding to Cease & Desist Letter

Great! You just spent thousands of dollars and untold executive time developing a new mark, and now this. You have received a cease and desist letter ("C&D") claiming you are infringing another company's trademark, and ordering you to immediately stop using your new mark.

This situation is painful, and familiar. Your response to the C&D requires careful analysis of the commercial significance of the "accused" mark, the strength of the mark that is allegedly being infringed, the likelihood of confusion created by both marks existing in the marketplace, and, perhaps most importantly, the sender's resources and reputation for enforcing its marks. These steps, of course, should have been taken in the course of developing your new mark. Early involvement of trademark counsel may have avoided the cease and desist letter altogether. Trademark counsel "clear" marks to determine whether they are safe to use. "Clearance" goes beyond merely searching for similar names. Some names that seem "taken" will be in fields so crowded that they are relatively safe to use. Other names that seem available may be worth avoiding because of the existence of a "famous" mark, or a mark holder with a reputation for vigorous ment of its marks.

It is difficult to precisely define the and scope of trademark rights. Until cha a mark is as strong as the owner says it ultimate challenge to a mark is federa litigation. But, it makes sense to avoid litigation unless absolutely necessary.

Paradoxically, avoiding litigation is t reason to involve skilled trademark li counsel as early as possible. A skilled tra litigator will be able to analyze the mar challenge the cease and desist deman litigator can help weigh the costs and of challenging the demand, versus neg changes to your mark.

To read the full report, go to www.point-of-law.com/COJK.asp

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ss Of Patent Rights – "Experimental se" vs. On-Sale/Public Use Bar

nts are often one of the most important a company possesses. The timing of filings is a crucial consideration for nies as new products are developed. ent claim is not valid if "the invention n public use or on sale in this country, than one year prior to the date of the ation for patent in the United States." 35 §102(b). The test is whether, prior to itical date, the claimed invention (i) was bject of a commercial sale or offer for r was publicly used by a person, other the inventor, who is under no confidentiality obligation, and (ii) was ready for patenting. Experimental use may negate public use, sale, or offer for sale in certain circumstances, but the experimentation must perfect a feature in the patent claims or improve or verify an inherent feature of the claims. The 102(b) bar has been used as a defense to patent infringement, and has been used to invalidate significant patents. The federal courts have held that it is not necessary that any party to the use, sale or offer for sale recognize the patentable characteristics of the product at that time to trigger the 102(b) bar; however, merely advertising an invention (without an actual offer for sale) will not trigger the 102(b) bar (but the content of the advertisement might constitute invalidating prior art). Recently, clinical testing of a drug did not qualify as an experimental use to negate the 102(b) bar where the tests were conducted to determine safety and efficacy, and did not involve the claimed features of the invention. Since the courts have focused on features of the patent claims with respect to 102(b) bar issues, patent claim strategies and patent filings should be developed early and matched with critical development dates in order to avoid a possible loss of patent rights.

To read the full report, go to
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ıying Your Lawyer: Contingent and ked-Fee Compensation

v did your company pay the last law t hired? You probably paid by the hour. ou didn't have to pay by the hour. ould have paid your lawyers on a fixed or gent basis. Few companies realize they egotiate these alternative compensation gements, and even fewer take advantage m. If you are paying lawyers by the hour, ay be missing a significant opportunity to igation expenses and improve the quality legal services you receive.

fixed fee arrangement, the client pays firm a set amount of money, either for certain time periods (for example, a flat monthly or quarterly fee for handling a case) or for completing a particular task related to an ongoing litigation (for example, a fixed fee for the trial itself). In a contingent fee arrangement, the client pays its law firm contingent on a certain result. This is usually a percentage of the amount recovered or saved, but it can also be a fixed or sliding scale bonus contingent upon obtaining or defeating a preliminary injunction or summary judgment or upon getting the case resolved by a specified deadline.

Paying lawyers on a contingent basis aligns their interests with yours. Paying lawyers a fixed fee allows accurate budgeting and eliminates friction over hourly time entries on monthly bills. In either case, the lawyer is discouraged from performing tasks that are unlikely to produce outcome determinative results.

Most companies assume they have no choice about how they pay their lawyers. That's wrong: You do have a choice, and you should ask your counsel about alternative compensation arrangements. Fixed or contingent fee arrangements may save you money, make your lawyers more efficient, and make them just as dedicated to winning as you are.

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From Patents to Assets: Intellectual Explosion of the 21st Century

The 21st century marks an explosion of U.S. patents, doubling the number of grants per year compared to the 90's from roughly a 100,000 to 200,000. Intellectual assets dominate the U.S. total economic output. An estimated 70% of value created by a company now comes from intellectual assets, not physical assets. This technology-driven intellectualization increases the emphasis on the need to protect intellectual property rights, bringing patents to the forefront.

It is inevitable to strategize patents as a stronghold of a company. Patented technology can be classified as either fundamental (e.g. disruptive) or non-fundamental (e.g. sustainable, "me-too"). Fundamental patents are a company's dream, but in fact are very scarce. The National Inventors Hall of Fame recognizes only 221 inventors who have been granted primarily fundamental patents, representing only a very small portion of all patents to date. Fundamental patents are most potent when paired with disruptive technology capable of replacing existing technology.

"Me-too" patents dominate the numbers. The value of these patents should not be underestimated since they are typically associated with technology advancement based on previously existing patents. These improvement patents typically redu improve efficiency, and lower costs.

Once a company decides to convert its in accomplishments into assets by pursuing p is critical that the patent strategy be sound. scientific, legal, and strategic quality. A sour strategy can only be derived by (1) peop in the technology preparing and pro the patent application to secure the allo broad claims, and (2) a thorough prior a ensuring that the claims are novel and non- Such a strategy maximizes success, m costs and optimizes intellectual asset v The value of patents is realized as asse capable of standing the test of licensin infringement cases, mergers and acquisitio

To read the full report, go to www.point-of-law.com/lumen.asp

Lumen

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California's Safe Drinking Water and Toxic Enforcement Act

In 1986, California voters passed an Initiative Measure, Proposition 65, "The Safe Drinking Water and Toxic Enforcement Act of 1986." This Act applies to anyone doing business in California. Proponents argued it was needed to address toxic polluters, contaminated drinking water, harm to children and the environment. The Proposition is divided into warning requirements and discharge prohibitions and requires the identification of certain chemicals known to the State of California to cause birth defects, other reproductive harm or cancer. Once chemicals are listed, manufacturers, distributors and retailers are required to comply with the warning and discharge requirements. Warnings for consumer products must be by conspicuous methods calculated to make it likely a reasonable consumer will read the warning. The law also prohibits the discharge of listed chemicals into water or upon the surface of land in a manner that could result in such chemicals passing into sources of drinking water. The primary enforcer of Proposition 65 is the Attorney General; the initiative also allows private citizens to bring suit after 60 days' notice. Private plaintiffs are acting as private attorneys general, and the initiative allows these plaintiffs to collect 25% of t levied in the case. This unusual provis spawned a new breed of plaintiffs, called tiffs for profit." As a further incentive t groups, attorneys fees and costs can be a The first cases brought to enforce Propos focused on traditional chemicals an exposure to individuals – mantles from l commercial paints, typewriter correctio and sterilizers. Subsequent cases have a ceramic ware, tableware, crystal de china, chocolate, lead wine bottle cove plumbing products. Proposition 65 cas to be quite specialized, requiring legal from law firms well-versed and experie the initiative and the litigation peculiar t

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McQuaid Bedford & Van Zandt is a San Francisco based firm with considerable trial and appellate expertis experience across a wide spectrum of business, tort and environmental matters (including a substantial number of Proposit clients and cases). The firm's practice extends throughout the Western States in water and natural resource matters. Additi the firm has an active corporate, employment counseling, real estate and land use practice. 415-905-0200 • www.mbv

ig Seniors on Campus

lleges are appealing to retirees by offering using complete with academic perks

OT OTS

THE TERM "COLLEGE-bound senior" has a new meaning. Many retirees have long favored college ıs for the concerts and lectures, for the ɔall and basketball, or to take courses ate schools virtually for free. But now ges are actively recruiting retirees housing that allows them to live on or cent to campus, and with many of the s enjoyed by faculty and staff.

he back-to-campus movement is rela- y new. About 20 colleges and univer- s have sponsored such housing for re- s, and about 40 more have projects in lopment, says Leon Pastalan, author *niversity-Linked Retirement Commu-* s and an emeritus professor of archi- ıre at the University of Michigan. ɔmers have always expected more," ıys. "When they start retiring in five s, they're going to demand more op- unities for personal growth. That's re the colleges come in."

esides the educational and cultural ulation and free or discounted tu- , a big draw of campus life for sen- is the opportunity to mingle with ge kids. Longview at Ithaca College an intergenerational choir that ts weekly and performs every se- ter (table). The University of Florida t a 350-seat auditorium at Oak ımock, a retiree complex less than a from campus, as a performance ıe for its music and drama students, its College of Journalism set up a TV io for residents. Some schools tap well-educated senior communities ecturers, or as a source of mentors students. Another benefit: Forging er ties to retirees results in more gen- ıs donations and bequests.

NIS COURTS

SENIORS, MUCH of the appeal ıs from the amenities, which vary by ɔol. Pennsylvania State University the University of Florida, for exam- issue IDs to residents that give them ights and privileges of school faculty, ıding access to campus recreation lining facilities and discounts at the schools' golf courses and tennis courts.

There's no single model for on-campus retirement housing. In Ann Arbor, the University of Michigan sold 20 wooded acres on its North Campus, home to the schools of Music and Art & Design, to a developer for University Commons, a condo complex for residents 55 and older. Longview, built across the street from Ithaca College in upstate New York on land donated by the school, offers monthly rentals: apartments for independent living and private suites for adults who need help bathing or with medications.

Other schools have opted for life-care facilities, called continuing care retirement communities (CCRC), that have everything from free-standing, single-family houses, to apartments for independent living, to fully equipped nursing homes to care for residents as they age. You must "buy in" to the community with a hefty entrance fee and monthly charges that sometimes include meals and, eventually, as much medical care as you need. For these, you can usually opt to pay an even higher entrance fee structured for tax planning: Similar to a charitable remainder trust, up to 90% of the fee is refunded to you if decide to move, or to your heirs or estate if you die.

Now, about those football tickets: No way at Notre Dame, Florida, and Michigan, but Penn State sets aside a block of 200 seats. Go, Joe Paterno!

PENN STATE You get all the rights of school faculty, such as access to sports facilities

LEAFY GROVES OF ACADEME

FACILITY / AFFILIATION	TYPE	PRICE
Holy Cross Village Notre Dame, South Bend, Ind.	CCRC*	$129,900 to $239,900 fee and $425 to $700/mo.
Longview Ithaca College, Ithaca, N.Y.	Senior living	Apartments: $1,400 to $2,600/mo. Assisted living: Up to $2,245/mo.
Oak Hammock University of Florida, Gainesville, Fla.	CCRC	$102,485 to $477,199 fee and and $1,150 to $4,350/mo.**
University Commons University of Michigan, Ann Arbor	Senior living	Condos: $263,000 to $609,000
Village at Penn State Pennsylvania State University, State College, Pa.	CCRC	$166,100 to $361,700 fee and $1,710 to $3,000/mo.**

*Continuing care retirement community **Includes nursing services when necessary

Data Company reports

ART DECO DOWNTOWN
Asheville, N.C., amid the Blue Ridge Mountains

At Home in the Hills

Settling near the mountains? That can be the high life for high-energy retirees

HOT SPOTS

FOR FOLKS WHO ARE active and determined to remain that way, there are few better places to retire than the mountains. You can hike, bike, climb, play golf, and ski—and as you get older, you can tune your activities to match your fitness level. As a bonus, the natural beauty and scenic views can be spectacular.

Some places, such as Coeur d'Alene, Idaho, and Prescott, Ariz., are onetime mining towns that have grown up into upscale resorts with live music and bistros to match those in the big cities. In Coeur d'Alene, in Idaho's panhandle, much of the recreation begins at the downtown lakefront. Hiking trails are easy to find and paved bike paths go from the lake to Spokane, Wash., 45 miles to the west, and east to the Montana border.

Historic Prescott, once Arizona's territorial capital, has an abundance of hiking and biking, too. Some 450 miles of multiuse trails traverse its forested slopes and pristine mountain lakes. The nightlife in Coeur d'Alene and Prescott peaks during the summer months—celebrity sightings are not infrequent—but there's enough going on in both places to support year-round communities of retirees.

If something smaller and more out-of-the-way is appealing to you, check out Sisters, Ore., population 1,400. It's named for three volcanic peaks in the Cascade range[illegible] little more t[illegible] wide spot in th[illegible] 25 miles nor[illegible] of Bend, Or[illegible] new boomto[illegible] laid-back style, Old West building[illegible] annual rodeo will remind you of Sa[illegible] N.M., say, 30 or 40 years ago. "It's t[illegible] and-coming place in central Orego[illegible] its natural setting is appealing to [illegible] and art galleries," says Bert Sp[illegible] whose *BestPlaces* books, magazin[illegible] cles, and Web site (BestPlaces.net) [illegible] been helping people find places t[illegible] work, and retire for nearly 20 year[illegible]

In the Midwest, Sperling pic[illegible] rolling hills of the Ozarks, about a[illegible] to mountains as you get in the mid[illegible] the country. "The Ozarks rate very [illegible] for affordability and livability," he[illegible] "It's one of my favorite spots for [illegible] ment." Fayetteville, home to the U[illegible] sity of Arkansas and its fabled [illegible] backs, is fast becoming the anchor [illegible] the region. Wal-Mart, headquarte[illegible] miles north, has made the area a de[illegible] tion for big business, which helped [illegible] upscale restaurants and a more so[illegible] cated lifestyle to the area.

BEST OF BOTH WORLDS

BACK ON THE BEATEN path, Ash[illegible] N.C., is a longtime favorite for re[illegible] Nestled in the Blue Ridge Mountain[illegible] college town provides rich educa[illegible] opportunities through the Univers[illegible] North Carolina at Asheville's Colle[illegible] Seniors. There's a symphony, an e[illegible] itely preserved Art Deco downtown [illegible] top-notch health care. An in-city ar[illegible] tum offers easy-to-moderate hikes [illegible] you have plenty of opportunities fo[illegible] trips to the mountain lakes an[illegible] springs for rafting, fishing, and mo[illegible] most every respect, such places can [illegible] an exhilarating experience for ener[illegible] vibrant retirees. ■

RECREATION HAVENS

PLACE	MILES TO BIG CITY (MILES)	MEDIAN HOUSE VALUE	ELEVATION (FEET)	AVERAGE TE[illegible] JAN. LOW/ JULY HIGH
Asheville, N.C.	Charlotte, N.C. **130**	$143,600	2,385	27/85
Coeur d'Alene, Idaho	Seattle, Wash. **310**	129,100	2,603	24/84
Fayetteville, Ark.	Kansas City, Mo. **240**	139,800	1,285	24/88
Prescott, Ariz.	Phoenix, Ariz. **100**	206,400	4,301	23/87
Sisters, Ore.	Portland, Ore. **150**	178,500	3,729	20/82

Data: BestPlac[illegible]

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Why Not Head North Instead?

Canada's entry rules are strict, but retirees say life there is well worth the trouble. **BY ELLEN HOFFMAN**

IF YOU DON'T NEED A PALM TREE on your patio, Canada can be an attractive place to retire. In addition to universal health care and cheap prescription drugs, our neighbor to the north offers a favorable exchange rate, surprisingly livable climates in places such as Vancouver, and a familiar, safe, English-speaking society (the last in all but Quebec).

But don't think you can just move across the border. Reluctant to extend its largesse to legions of retirees from the south, the Canadians have stringent requirements for establishing residency.

Some U.S. retirees, such as John Paulson, 69, and his wife, Colleen, 43, got into the country because they have family ties. The Paulsons, who moved four years ago from Portland, Ore., to Kelowna, B.C., in the Okanagan Valley, about a 3½-hour drive east of Vancouver, qualified because her mother was Canadian and Colleen had dual citizenship.

THREE WAYS TO PLAY

WITHOUT A FAMILY TIE, your can try to qualify as an investor or entrepreneur. Investors must show a net worth of about $607,000 (U.S.) and fork over what Mike Bradley, senior financial analyst for the government's business immigration section, calls "a pound of flesh." That's $304,000 (U.S.) to be invested for five years in a noninterest-bearing, economic development account. If you plan to start a business, you must have a net worth of $228,000 (U.S.). You also must show business experience and guarantee that the startup will create the equivalent of at least one full-time job in Canada within three years. This is best for those who want to work for a while before retiring.

If you apply to immigrate through the Canadian government, the paperwork typically takes about three years, Bradley says. But go through the "provincial nomination" programs and you may be able to cut the time to about a year if you have the skills or type of business a particular province is seeking.

Most Americans willing to jump through the immigration hoops do so for lifestyle reasons. "The quality of life is so much better up here," says Colleen Paulson, who was a real estate agent in Portland, while her husband worked for a district office of the Federal Aviati ministration. Their house has a r tain view, and she likes "the arid cl with summer temperatures be about 70 and 90 degrees." Winte peratures are no worse than, say Colo. Their routine includes golfing, hiking, skiing, and fishing. She also makes pottery in a home studio.

Your combin tax tab likely t be 8% to 15% higher

Retirees who prefer an urban lifestyle can choose from a number of cosmopolitan cities. Vancouver on the West Coast has the most moderate climate, with average temperatures in the 40s in January and February. Toront Montreal are exciting places, but winters are much colder and longer

Be aware that regardless of wher live, you must help finance your resi benefits by paying taxes to Canada a as to the U.S.—and the rates diff pending on the province. Althou treaty between the two countries wil you avoid double tion, your total tax likely to be 8% to higher than in the U

If you don't wa establish residency can still make Ca part of your retire lifestyle. That's Richard and Kath Lawson, ages 72 an do: They spend up months a year th the maximum p nonresidents can st a time—but pay taxes and go to doctor in the U.S. about $330,000 (the Williamsburg couple bought a 21st- 1,260-square-foot To apartment with a vi Lake Ontario. Whe town, they enjoy the ater, Blue Jays games "tons of restaurants cessible by subway. wonderful change of from the sultry env where they live the r the time. ■

KELOWNA, B.C. The Paulsons have mountain views.

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Hiking and Biking Into the Sunset

Baby boomers are redefining planned communities for older adults. BY CAROL MARIE CROPPER

THE GREATEST GENERATION faded away to 1,200-square-foot retirement condos in Florida or the Arizona desert, but the housing industry envisions something markedly different for the next wave of retirees. Instead, builders are serving up 2,000-plus-square-foot houses—complete with fancy fixtures such as granite countertops and home offices with high-speed Internet access—to a more affluent, more active, more demanding bunch. Developments are often within commuting range of a major city, providing work opportunities for the late-middle-age residents such communities attract, as well as access to cultural activities and the kids and grandkids. They have hundreds of units rather than the thousands of earlier communities—the better to lure boomers who have always disdained being part of the herd.

Call this "next-stage housing"—retirement developments for people who aren't necessarily retired, though they may be ready to downsize from their 4,000-square-foot, four-bedroom empty nests. Such communities are sprouting outside metropolitan areas such as Boston, Chicago, New York, Sacramento, and Washington. Some, such as Leyland Alliance's planned community in Warwick, N.Y., feature a "new urbanism" design, where homes are built around a town square or Main Street, providing walking access to restaurants and s

Baby boomers, with their $17 trill net worth, are the catalyst for this ch Boomers hope to retire earlier thar parents, says John Migliaccio, presid the American Institute of Financial C tology, a Deerfield Beach, (Fla.) con that trains financial professionals to with older clients. But that doesn't they want to leave the labor force pletely, so they need to be near job cording to a 2003 survey by Del Web Phoenix company that developed many consider the first planned com nity for seniors—Sun City, Ariz., in (Del Webb has since been acquire homebuilder Pulte Homes). The found that 24% of those polled wa move into their retirement home b they turn in the washroom key. A mo cently released study shows that 36 boomers either have moved or pl move after the kids take flight, and th ing close to an urban center is espe important to the youngest boomers.

FEWER CHORES

HELENE GARGAN, 52, is an examp the younger, not-quite-retired resi who are buying into these new dev ments. Gargan traded a 1.5-mile dr her software-testing job in Quincy, M near Boston, for an hour-long com when she moved to the Great Island

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cle shown with available equipment. Toyota Vehicle Stability Control (VSC) is an electronic system designed to help the driver maintain vehicle control under adverse conditions. It is not a substitute for safe ving practices. Factors including speed, road conditions and driver steering input can all affect whether VSC will be effective in preventing a loss of control. Please see your *Owner's Manual* for further details.

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munity in Plymouth, Mass. Sure, she spends more time commuting, but she more than makes up for it with the hours she saves in maintenance chores. That's a major draw of the new communities, which often have staff to take care of such things.

At the six-bedroom Boston duplex that had been in Gargan's family since 1921, "there was always the grass to cut, the hedges to trim," she says. "There was always the snow to shovel in winter. I could spend five hours shoveling out." Now she pays a monthly maintenance fee for others to do the work while she enjoys the lake view from her 2,400-square-foot house, with walking trails, canoeing, and kayaking nearby.

Another attraction: Fellow residents at Great Island aren't the stereotypical retirement community of shuffleboard players. Instead, Gargan sees her neighbors biking and hiking. "I don't consider myself old, and everyone I've met is quite vibrant," she says.

Golf, the mainstay feature of yesteryear, is often no longer the major draw at many of these newer communities. Instead, there are high-tech fitness centers, extensive walking trails, and college courses that are taught on-site. "Our clubhouse amenities are being designed for a more active resident," says David Smith, a vice-president at D.R. Horton Inc., whose Cambridge Homes unit developed Carillon Lakes in Crest Hill, Ill.

Even many of the older residents are more active. Iris Kisli vice-president at an that books author celebrities for speaki gagements. She work her new two-bedroon at the two-year-old set Run (N.J.) develo about 37 miles south Manhattan. For her, t ability to hand off nance chores was a reason to trade in he bedroom home in North Brunswick, N.J still close to her two ters and three grandc and remains within muting distance of M tan, where her compar fice is located. Three who are friends hav bought homes in the community.

Some of these de ments have age restri requiring most resid be either 55 or older o older, depending o community. But a gr number are "age targeted." That they're designed to attract older simply by not being convenient to s and playgrounds and by offering that have two bedrooms rather th family-friendly three or four. Some opments are designed as blended munities with a wider range of age are still not appropriate for familie very young children, says Migliacci

NOT YOUR PARENTS' RETIREMENT HOME

Around metropolitan areas, communities are springing up that are designed to appeal to more active older adults who may still be working and want to remain close with family and friends. In the developments below, at least one person in the household must be 55 or older.

Carillon Lakes Crest Hill, Ill. 815 436-0647	Houses and townhouses 35 miles southwest of Chicago, built around six lakes for fishing, hiking, boating. $158,000 to $234,000.
Falls Run Fredericksburg, Va. 540 361-1740	Townhouses and houses in gated community 40 miles south of Washington, 45 miles east of the Blue Ridge Mountains. $170,000 to $305,000.
Great Island Plymouth, Mass. 508 209-8500	Houses and townhouses in pine forest 45 miles south of Boston. Some with views of lake or Plymouth Bay. $300,000 to $500,000.
Somerset Run Somerset, N.J. 732 563-2800	Houses and condominiums in gated community 37 miles from Manhattan. $290,000 to $439,000.
Sun City Lincoln Hills Lincoln, Calif. 800 483-4834	Houses located 25 miles northeast of Sacramento. A couple of hours' drive from either San Francisco or Lake Tahoe. $284,000 to $496,000.
Warwick Grove Warwick, N.Y. 845 351-2900	Plans houses, townhouses, and condos 55 miles north of Manhattan. Community designed around a main street shopping area. $325,000 to $700,000.

LINCOLN, CALIF. Jogging and hiking trails are key features

THE NICHE GOES MAINSTREAM

SOME OF THE PREFERENCES de ers are catering to—such as the u retire within range of a major city remain close to the old home, wi connection to family and friends— necessarily new, says Dave Schrei Pulte Homes vice-president. It's jus when the retiring generation was s er, builders focused on the movi Florida mainstream rather tha niches. But boomers are 76 m strong—and they do differ from ge tions that preceded them.

People are living and rema healthy longer. So it was perha evitable that builders would design munities to bridge the gap between ily living and the old-age developme yore. As they have done before in areas, boomers now are busily rede retirement living. ■

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BY ROBERT BARKER

AT&T: A Buy Just for the Dividend?

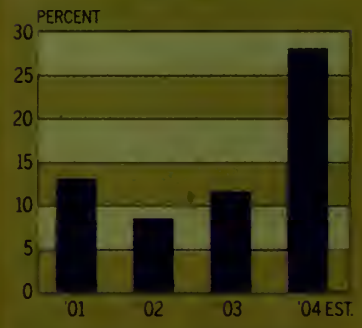
No stock today is hated more than AT&T. Booted out of the Dow Jones industrials in April, AT&T now is recommended by none of the 26 Wall Street firms that rate it, according to Standard & Poor's. Yet the clearest sign of how deeply AT&T is loathed is its dividend yield. Near $15, the stock is yielding a junkadelic 6.2%.

Which could be a good thing. Good, that is, if you haven't owned the stock during its epic collapse, and good if you buy it now and the telecom titan is able to keep paying the current 95¢-a-share annual payout. Will it? A spokesman told me AT&T's board has not indicated that the dividend is either in danger or sacrosanct. Yet worries abound. Under withering pressure on prices and regulatory setbacks, AT&T recently revised its 2004 outlook. Boy, is it bleak: 13% or so smaller revenue, from 2003's $34.5 billion, and a plunge in operating income, to maybe $1.2 billion from $3.9 billion last year before extraordinary charges. The gloomy forecast prompted S&P and Moody's Investors Service to begin studying whether to lower AT&T's credit rating, already just two notches above junk.

DESPITE THESE SOBERING prospects, there is some reason to suspect that AT&T's dividend will survive. I say this not because I enjoy any special clue about the board's intentions. As Moody's Senior Vice-President Dennis Saputo said, AT&T's finance department surely is laboring over spreadsheets to work through each option, from maintaining the dividend to trimming or even ending it. Each is possible, and a move could come on July 22 when AT&T reports second-quarter results. Yet if you look past AT&T's income statement to its statement of cash flows, the dividend appears to be in less imminent danger. To see what I mean, let's examine two scenarios: a bad case, taken from management's current expectations, and something worse.

TIGHTER TIMES

Dividends paid by AT&T as a percentage of free cash flow



Data: Company reports. BusinessWeek estimate

The Bad. At last report, AT&T had nearly 794 million sh outstanding, so each quarter's 0.2375¢-a-share dividend implies a total cash payment of $189 million to 2.7 milli shareholders. In the first quarter, AT&T met that easily w free cash flow—that is, cash flow from operations minus capital spending—coming in at $803 million. The balan the year promises to be tougher (chart). On an estimate billion in 2004 revenue, I guesstimate AT&T could colle $4.5 billion in operating cash flow. That's down plenty f last year's $8.5 billion. At the same time, though, AT&T slashed its budget for capital spending, to $1.8 billion th year from nearly $3.2 billion in 2003. on its sharply diminished expectation means AT&T still can expect to have ca enough after capital projects to cover year's dividend payments more than 3 times over.

The Worse. What if, as many analysts h already concluded, revenue and cash f fall only further in 2005? Given the ho price competition AT&T is trying to fa down, that seems a safe bet. So let's suppose revenue slides next year not another 13% but by 20%, to $24 billio Operations then might generate, say, billion in cash. Subtract $2 billion of t for spending on capital projects, and still would have more than twice the ca needed to maintain the dividend. An unavoidable risk: If AT&T cuts capital spending too drastically, it could sabot the quality of its telecom network and ultimately its appeal to the big busines that demand more complicated—and profitable—services. "It's clearly the premier network for the enterprise customer in the U.S.," said Moody's Sa who sees no evidence that less investm has dented service quality yet. A spoke for AT&T says the company has investe more than rivals over many years and now can lower capital spending safely.

Without an eventual end to price-cutting and a pickup demand for its services, no amount of financial juggling save AT&T's payout. Still, the company has time to turn t around. With the stock low enough to make for a 6.2% dividend yield, it's expressing more fear than reason. ■

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BY DAVID HENRY

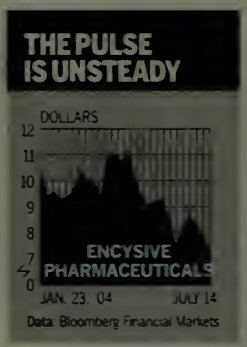
A NEW DRUG FOR HYPERTENSION COULD GET ENCYSIVE TICKIN

DOW CHEMICAL WILL GET A LIFT FROM A WAVE OF PRICE HIKES

MIDEAST TECH CONTRACTS MAY BOLSTER CACI INTERNATIONAL

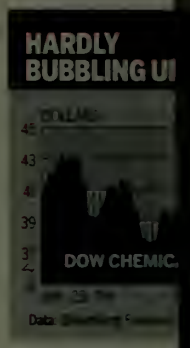
Taking Encysive to Heart

BUYING INTO A COMPANY that bets heavily on a single new drug is dicey. But it's a risk worth taking in the case of Encysive Pharmaceuticals (ENCY), says Mark Monane of brokerage Needham. Encysive is in the third and final phase of bringing to market a pill for pulmonary arterial hypertension. The disease forces the heart to work too hard to pump blood through constricted arteries into the lungs, causing shortness of breath and exhaustion. Untreated, it results in heart failure and death about four years from diagnosis. An estimated 50,000 people in the U.S. are afflicted. The most effective current treatment is a drug called Flolan, which is pumped round the clock through a tube into the chest. The cost: $100,000 a year. Swiss company Actelion recently came to market with a twice-a-day pill, for which it charges $30,000 a year. Encysive's pill, Thelin, is swallowed once a day. In trials so far, Encysive says Thelin users were able to walk significantly farther in treadmill tests than untreated patients. Monane, whose firm was an underwriter for Encysive, expects more data to come out by early next year and lift the stock from its recent 7.32 toward his 12-month target of 14. He says Encysive will be able to sell the drug for $25,000 a year, making its first profit in 2006. Deutsche Bank analyst Jennifer Chao rates the stock a buy with a target of 16.



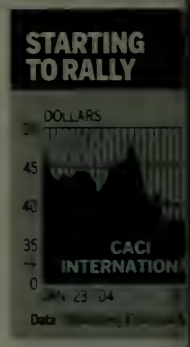
Rising Prices: Just The Catalyst Dow Needs

ONE YEAR AGO, Earl Gaskins, managing director at Brandywine Asset Management, told this column that shares of Dow Chemical (DOW), then trading at 30, were worth 42. Six months later, the shares had reached his target, up 40% on rising chemical prices. The shares have since slipped to 39, but Gaskins says there's another gain coming. His firm is still holding its 300,000 shares. Why? The current wave of chemical price rises is going to last longer than anyone thought, delivering higher and higher profits to Dow well into 2006. New supply, which had been expected to come from Middle East competitors, particularly in Iran and Saudi Arabia, and push prices back down, has been delayed. Dow's annual earnings will jump from this year's estimated $2.18 a share to $5.50 in 2006, says Gaskin. He's modestly raising his price target to 48. Standard & Poor's says the shares are worth 55. Indeed, Gaskins thinks the stock could get a second lift if Dow gets a break on the cost of its oil and natural gas feedstocks. The company has been cutting payroll and other expenses even while raising prices.



CACI Is Helping Uncle Sam in Iraq

AS A GOVERNMENT contractor doing business in I CACI International (CAI) has had more than its sh of public scrutiny. When word spread that some o employees had interrogated prisoners, the General Servi Administration opened an investigation of its contracts. of the probe knocked the stock down on May 27 by 5%, t Since then, the GSA has found the company's papers in o and the stock has rallied to 41. Richard Cripps of Legg M says it could hit 52 in a year. Advest Group has a buy rati on the stock, too, with a target of 53. Cripps says CACI shares are trading for just 17 times earnings for the fiscal year ending next June, according to estimates by Legg Mason, which does investment banking for the company. The price-earnings ratio could mount as prisoner-abuse headlines fade and investors focus on CACI's steady 20% annual earnings growth, he says. Growth comes mainly from U.S. outlays for security, info-tech upgrades, and outsourcing. CACI, a government contractor for all of its 42 years, is a pure pla the trend. Some 93% of its $1.1 billion of revenues come f the federal government. ■



Gene Marcial will be back next

BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/ today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays. See Gene on Fridays at 1:20 p.m EST on CNNfn's *The Money Gang*.

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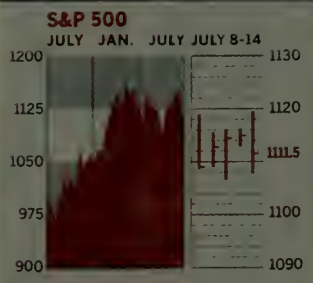


COMMENTARY

Hurt by lack of major economic news, stocks remained in the doldrums this week. New jobless claims fell, but that good news was offset by weaker June sales at such retailers as Wal-Mart and the Gap. Also troubling was a Merrill Lynch downgrade of the tech sector on July 12. Then on July 13, Intel's quarterly report disappointed the market, leading to a sell-off in its shares.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	JULY 14	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1111.5	-0.6	-0.1	10.7
Dow Jones Industrials	10,209.4	-0.3	-2.4	11.2
NASDAQ Composite	1914.8	-2.6	-4.4	9.1
S&P MidCap 400	584.8	-1.3	1.5	16.4
S&P SmallCap 600	282.4	-1.9	4.4	20.7
Russell 3000	628.7	-0.9	-0.2	11.1
SECTORS				
BusinessWeek 50*	639.5	-1.2	2.8	8.0
BW Info Tech 100**	328.0	-3.0	-6.4	2.2
S&P/BARRA Growth	550.1	-0.8	-1.1	7.8
S&P/BARRA Value	557.3	-0.5	1.0	13.7
S&P Energy	255.6	0.5	14.0	33.9
S&P Financials	376.4	-0.8	-0.9	7.5
S&P REIT	121.3	-1.2	6.6	17.0
S&P Transportation	200.5	-0.9	-0.7	11.3
S&P Utilities	121.0	0.4	2.1	11.4
GSTI Internet	149.5	-4.5	3.3	11.0
PSE Technology	680.0	-2.6	-2.5	13.3

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	JULY 14	WEEK	% CH YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1182.6	-0.4	0.3
London (FT-SE 100)	4372.6	0.3	-2.3
Paris (CAC 40)	3648.8	-0.3	2.6
Frankfurt (DAX)	3898.8	-0.8	-1.7
Tokyo (NIKKEI 225)	11356.7	-0.2	6.4
Hong Kong (Hang Seng)	11932.8	-3.1	-5.1
Toronto (S&P/TSX Composite)	8458.3	-0.2	3.0
Mexico City (IPC)	9843.0	-2.0	11.9

FUNDAMENTALS	JULY 13	WEEK AGO
S&P 500 Dividend Yield	1.66%	1.66%
S&P 500 P/E Ratio (Trailing 12 mos.)	20.8	20.8
S&P 500 P/E Ratio (Next 12 mos.)*	16.3	16.4
First Call Earnings Surprise*	4.19%	7.78%

*Fir

TECHNICAL INDICATORS	JULY 13	WEEK AGO
S&P 500 200-day average	1102.1	1099.9
Stocks above 200-day average	60.0%	63.0%
Options: Put/call ratio	0.85	0.81
Insiders: Vickers NYSE Sell/buy ratio	3.58	3.07

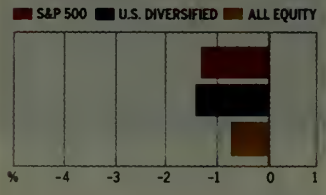
BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Steel	19.5	Internet Software	90.3
Divsfd. Metals & Mining	17.5	Steel	80.8
Gold Mining	13.6	Oil & Gas Refining	79.1
Home Furnishings	11.8	Divsfd. Metals & Mining	68.8
Oil & Gas Exploration	10.7	Fertilizers & Ag. Chems.	63.0

WORST-PERFORMING GROUPS	LAST MONTH %	
Health-Care Distributors	-21.9	Health-Care Distributor
IT Consulting	-21.3	Airlines
Semiconductors	-13.5	IT Consulting
Advertising	-12.0	Broadcasting
Semiconductor Equip.	-10.6	Semiconductor Equip.

MUTUAL FUNDS

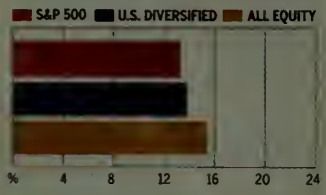
4-WEEK TOTAL RETURN

WEEK ENDED JULY 13



52-WEEK TOTAL RETURN

WEEK ENDED JULY 13



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Precious Metals	8.7	Natural Resources	38.8
Natural Resources	4.9	Japan	36.6
Real Estate	4.2	Precious Metals	33.2
Latin America	3.6	Latin America	31.7
LAGGARDS		**LAGGARDS**	
Technology	-5.9	Technology	5.8
Small-cap Growth	-2.6	Large-cap Growth	8.1
Mid-cap Growth	-2.4	Health	8.5
Health	-2.4	Domestic Hybrid	9.0

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
PFds. Pr. Mtls. Usr. Inv.	12.2	Fidelity Japan Small Co.	71.8
Midas	11.2	U.S. Glbl. Invs. G. Rscs.	69.2
Scudder Gd. & Pr. Mtls. S	10.0	U.S. Gl. Invs. Prc. Mnls.	66.2
Am. Cent. Gl. Gold Inv.	10.0	iShares MSCI Austria Ix.	62.2
LAGGARDS		**LAGGARDS**	
ProFds. Smicdr. Ultsr. Inv.	-13.1	Frontier Equity	-31.6
ProFds. Intnet. Ultsr. Inv.	-11.8	Ameritor Investment	-30.8
Firsthand Tech. Innovators	-10.7	Grand Prix A	-29.5
Reynolds	-10.7	Thurlow Growth	-27.8

INTEREST RATES

KEY RATES	JULY 14	WEEK AGO
Money Market Funds	0.79%	0.77%
90-Day Treasury Bills	1.33	1.30
2-Year Treasury Notes	2.59	2.54
10-Year Treasury Notes	4.48	4.48
30-Year Treasury Bonds	5.22	5.22
30-Year Fixed Mortgage†	6.00	5.99

†BanxQuo

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR.
General Obligations	3.83%	
Taxable Equivalent	5.47	
Insured Revenue Bonds	4.00	
Taxable Equivalent	5.71	

THE WEEK AHEAD

RESIDENTIAL CONSTRUCTION *Tuesday, July 20, 8:30 a.m. EDT* » Housing starts are forecast to have rebounded to an annual rate of 2 million in June. That's according to the median forecast of economists surveyed by Action Economics. During May, starts slipped to an annual pace of 1.97 million. Mortgage rates dipped following the June 30 interest-rate hike by the Federal Reserve. That could spur some more last-minute activity, as mortgage rates are expected to climb as the Fed keeps raising rates.

INITIAL UNEMPLOYMENT CLAIMS *Thursday, July 22, 8:30 a.m. EDT* » New filings for state unemployment claims probably edged back up to 320,000 during the week ending July 17. In the week ended July 3, new jobless claims dropped to 310,000, the lowest reading since late 2000. Claims data have been volatile lately. However, the trend supports expectations of a rebound in the July jobs data, after a lackluster 112,000 gain in June.

LEADING INDICATORS *Thursday, July 22, 10 a.m. EDT* » The Conference Board's June index of leading economic indicators is expected to have climbed 0.2%, following a 0.5% jump in May. Brighter consumer sentiment probably gave the index a boost.

The *BusinessWeek* production i jumped to 221 for the week e July 3, an 11.9% increase from a ago. Before calculation of the week moving average, the i surged to 225.9.

BusinessWeek onl

For the BW50, more investme data, and the components of the production index visit www.businessweek.com/magazine/ext

he Companies

index gives the starting page for a story or feature with a ficant reference to a company. Most subsidiaries are indexed under r own names. Companies listed only in tables are not included.

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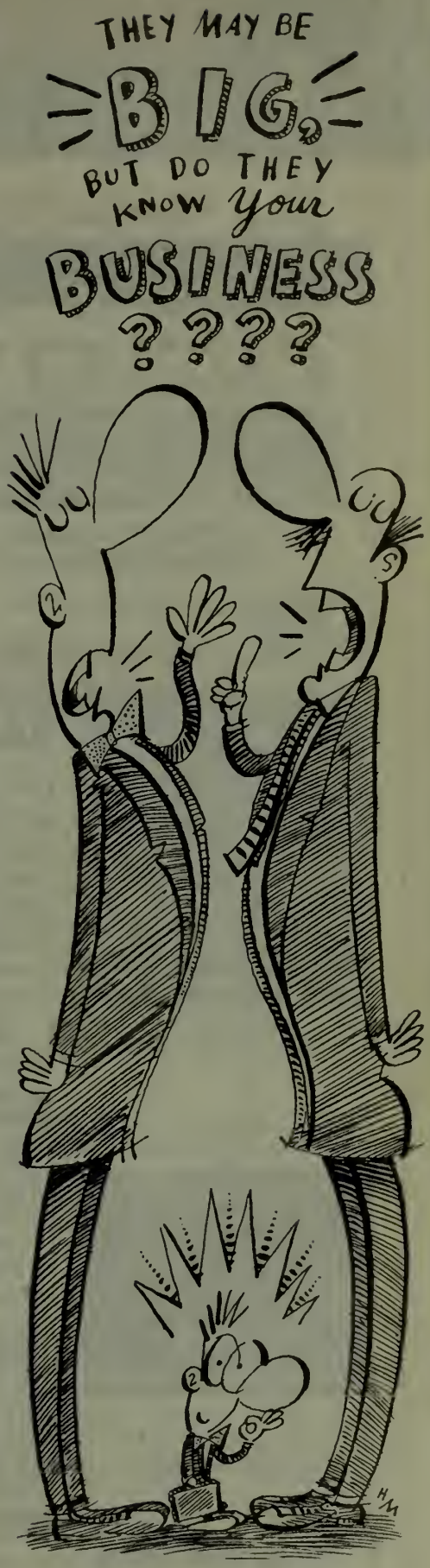

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GOLD MARKET EXPLODES

Times were different when President Reagan was in the White House. Today the war on terrorism and the escalating violence in Iraq are daily news events. Add to the equation over 8,000,000 (8 million) unemployed Americans, rampant corporate fraud, out of control government spending, the inability to balance the budget and you have an insurmountable debt that tops $7 Trillion and continues to grow each and every minute. President Reagan understood the need to protect the American public. One of his strategies was to make it easy for everyone to own Gold. This vision was absolutely correct. The Gold Market has outperformed the S&P 500 for the past five years. In addition, the performance of CD's and savings accounts can't even come close to the gains that Gold has made. This is why now is the time to move paper assets into Gold. It is crucial that individuals move now because as soon as tomorrow, Gold could start it's predicted steep rise from $390 to $1,500 per ounce.

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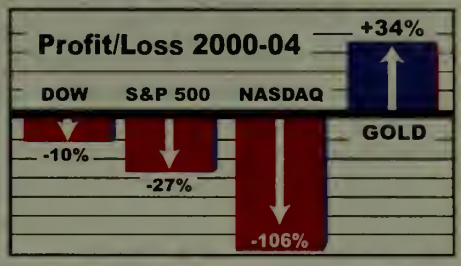

Trusting your financial future to the stock market's performance has been a bad situation for the past 5 years. In fact, the above graph clearly shows that not only the DOW, but the S&P 500 and NASDAQ are all down from January 2000. Gold, on the other hand, is up 34% since January 2000. If you had purchased $50,000 worth of Gold in January 2000, that same gold would be worth $67,000 today - a profit of $17,000. Most stocks cannot even come close to that gain. The Gold Market is on the move and is showing signs of taking off like a rocket. Many experts can offer excellent insight into the future price trends of Gold, but no one, including The United States Rare Coin and Bullion Reserve, can guarantee a Gold Coin's future value will go up or down. Do not wait to move your hard earned money out of stocks and into Gold.

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Ken Lay's Lame Excuse

IF KENNETH LAY didn't know, he should have. The same goes for WorldCom's Bernard J. Ebbers, Adelphia Communications' John Rigas, and HealthSouth's Richard M. Scrushy. All four chief executives are using ignorance as a legal defense in financial disasters that have cost employees, retirees, and shareholders deep suffering. But the cost is even higher for Corporate America. The very idea of CEOs hiding behind "plausible deniability" casts business in a terrible light. In a society that preaches individual responsibility, arguing that "I didn't know" undermines the moral authority of business culture (page 30). If CEOs aren't responsible for their companies, who is?

Ken Lay can use any defense he wishes, but his claim of ignorance is hardly plausible. The Enron men accused by the government of committing widespread fraud—former CEO Jeffrey K. Skilling, Chief Financial Officer Andrew S. Fastow, and chief accountant Richard Causey—weren't distant underlings. They were Lay's closest lieutenants at the highest levels of the company. And what Skilling and Fastow did was part and parcel of Enron's business model. Without the fraud, Enron would not have been nearly as profitable. How could Lay not be held responsible for his people and what they did?

Chief executives are usually reluctant to talk publicly about other CEOs' travails. But they should make an exception in the case of Ken Lay and other executives who plead ignorance in denying their corporate and public responsibilities. It is time to shame these people, and there is no better way than for their colleagues to condemn them.

Retirement: Plan, Don't Panic

BABY BOOMERS are in a frenzy about their retirement. The oldest turn 62 in 2008, and everyone from their financial advisers to their mothers has told them they don't save enough. Politicians make it worse with dire warnings of Social Security's imminent demise. With time running out, many boomers worry that the scolds may be right and they won't have enough money to retire. Well, the boomers should stop fretting about eating cat food in their dotage. *BusinessWeek*'s Retirement Guide (page 76) shows they have amassed m wealth than their parents did at a comparable age, earn real income, and save at roughly the same rate. They als have better prospects of working longer into retirement i they choose. Many will. Just how much golf can anyone

As for Social Security, it isn't going broke anytime soo The Congressional Budget Office says the Social Security Trust Fund will hit empty in 2052. But that is based on l estimates of productivity and economic growth. If curren levels are sustained, Social Security probably won't run o

Boomers should fret about Medicare. The gap betwee promised benefits and dedicated payroll taxes runs into t tens of trillions of dollars. Some judicious means-testing needed to make Medicare function as a smaller, but real, safety net. Even so, there is no reason for boomers to live fear at the prospect of an impecunious old age. When it c to retirement, a little planning goes a long way.

Scott McNealy's Last Stand

THAT WHICH MAKES us great is often which brings us down. The rise of Sun Microsystems Inc. and its founder and CEO Scott McNealy brought a strong d of innovation and dynamism to high t in the '90s. Sun became a powerful, creative force offering corporate consumers alternatives to offerings from such standard bearers as Microsof Corp. and IBM. Sadly, the in-your-face irreverence and determination that marked McNealy's success also led hi make serious mistakes. McNealy, with his usual chutzpah verve, is now struggling to turn Sun around (page 64). Sil Valley risks losing an innovative competitor if he doesn't.

It's hard to fault a CEO for refusing to cut R&D spendin and fire employees in the face of adversity. But when the t bust hit in late 2000, that's what McNealy did. He believe that technology had changed the business cycle. He fough entreaties from his managers to cut spending, and he rebuffed customer requests for cheaper products.

McNealy had bucked conventional wisdom before. In t '80s, he overruled his own executives and chose to develo Sun's own chips. He invested big in Sun's Solaris software 1995. Then, as the Internet boom took off, he put Java software into Sun gear. All three big bets paid off big. Ther his luck ran out: The tech wreck went from bad to worse a lasted longer than he guessed. In the end, he chopped spending but lost his senior staff and Sun's edge.

McNealy is placing yet one more bet on reviving Sun. H high-low strategy calls for developing advanced chips that handle dozens of tasks while giving away low-end servers customers that agree to buy its software. It's a gutsy move. and the high-tech world will be better off if it's not his last.

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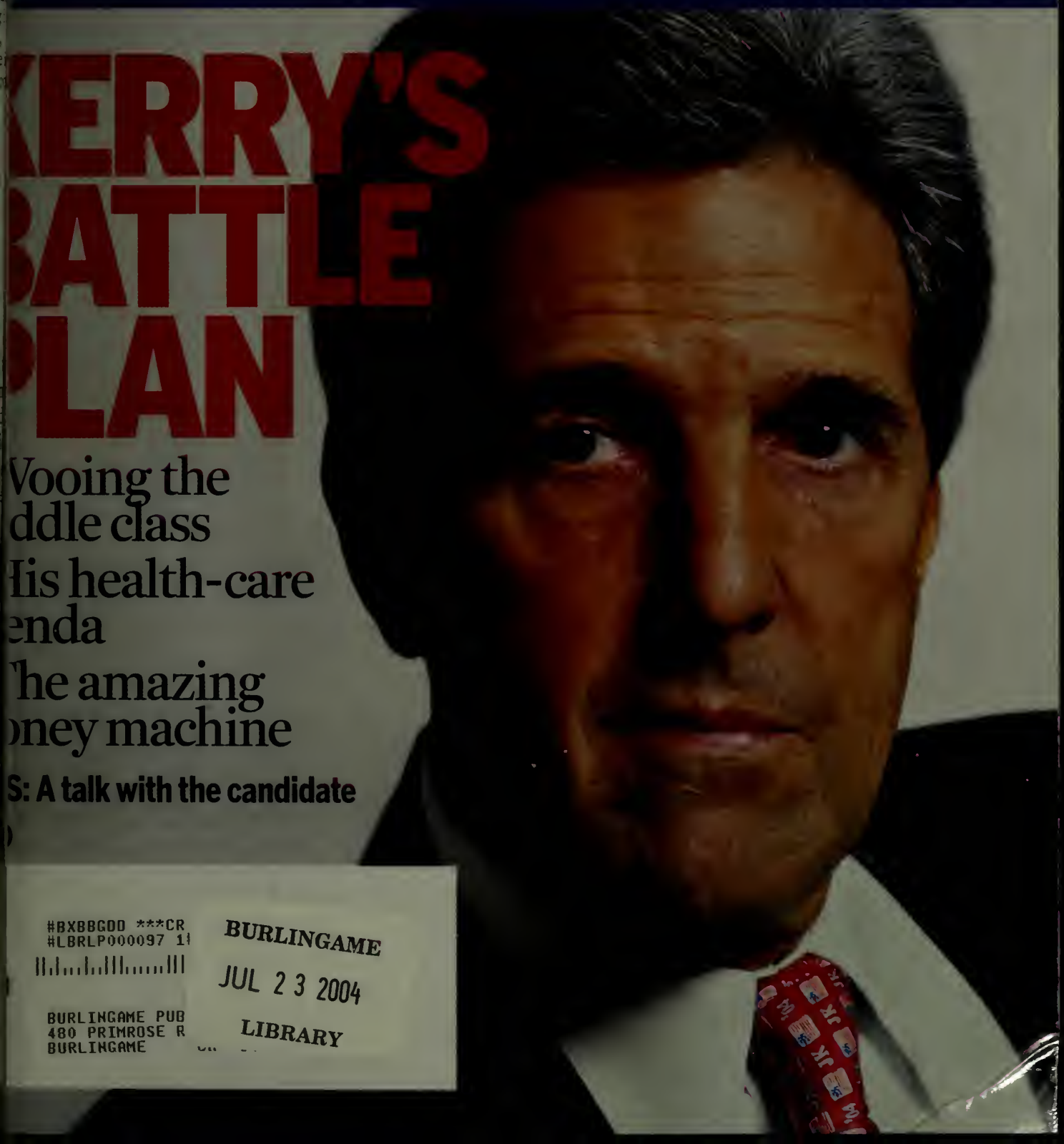

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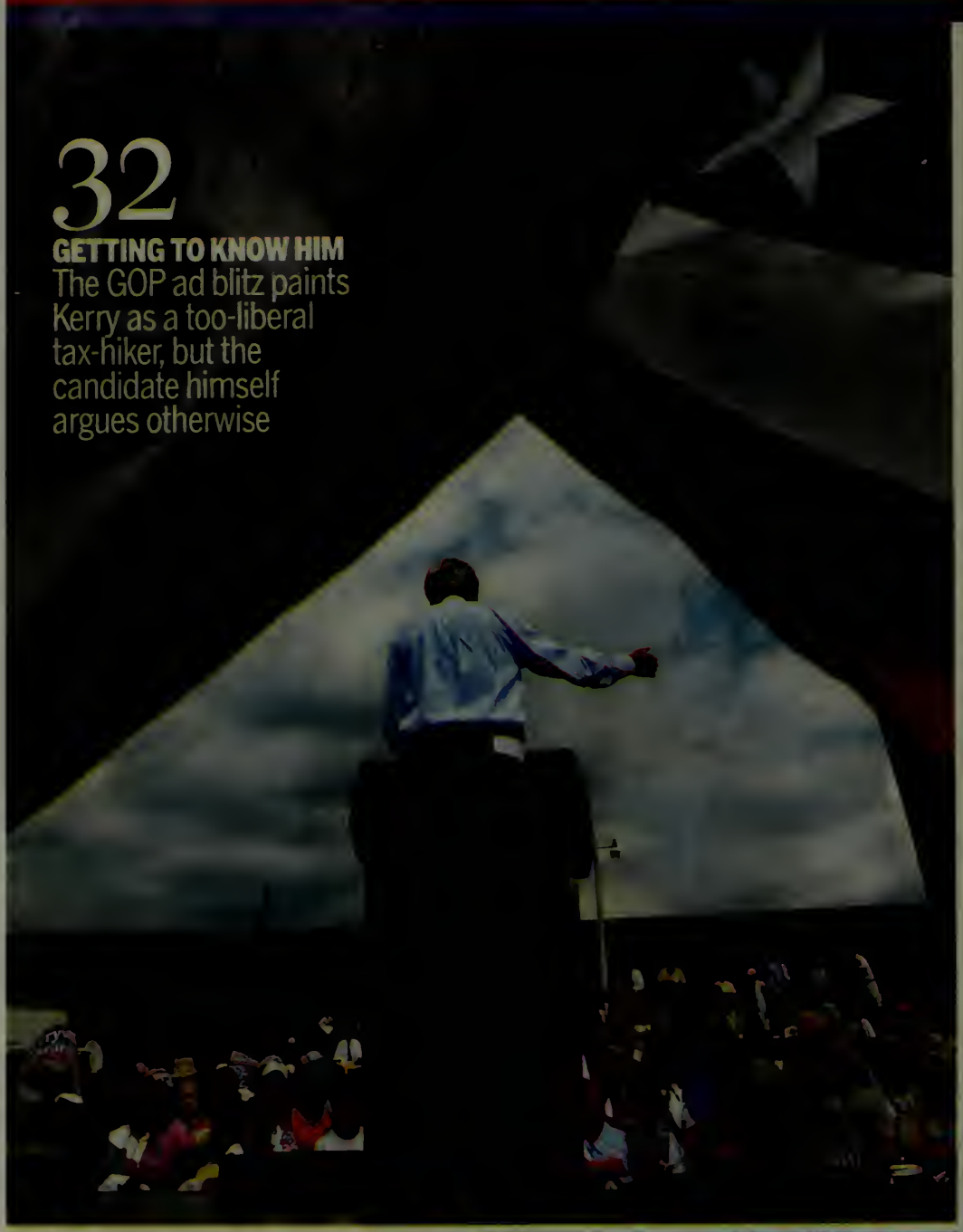

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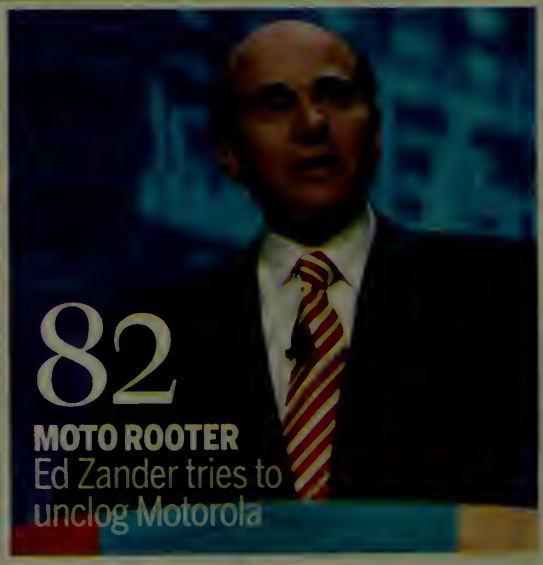

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"HENDRICK'S WON THE GIN CATEGORY"...
- THE WALL STREET JOURNAL

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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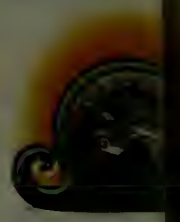
Earnings: Investors Might Hit Some Speed Bumps in '05



Veteran profits forecaster Chuck Hill says this earnings season is going gangbusters so far. But he worries that investors haven't fully priced in a slowdown he's pretty sure is on the way

Is Nokia Really So Bad Off?

Its second-quarter report was hardly confidence-inspiring. Revenues fell by 5% while margins for its mobile-phone unit dropped from 27% a year ago to just 19%, and investors bolted for the exits. They may be overreacting—at least a little

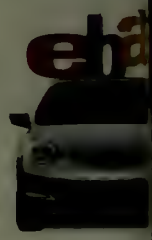
It's Not All Gloom on the AIDS Vaccine Front

Although the long quest for a safe, effective vaccine is still aching for a breakthrough, important advances are steadily being made. Lots more funding sure would help

Productivity, Productivity, Productivi

That's new CEO Gary Kelly's management philosophy at Southwest Airlines, especially in the wake of a bitter labor disp with flight attendants that has upped the low-fare airline's overhead while the downward pressure on fares continues

A Speed Demon Called eBay Motors



"You get a good deal, and it's safer," says Simon Rothman, general manager of the auction giant's fastest-growing category

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JP Front

"We told FASB to fix this problem. Now we're telling them...that the political fix is in."

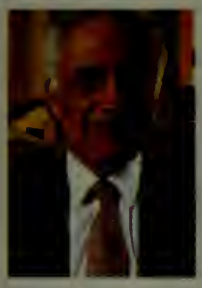
–Representative John Dingell (D-Mich.), on a bill to block a rule requiring companies to expense options

ED BY IRA SAGER

R TALK

CE SOUND STEM, CE RIDE

AUTO COMPANIES such rsche and **Mercedes-** trumpet **Bose's** stereo ms to bolster their own ds. They could soon to Bose to supply a -fidelity ride for hole car. *usinessWeek* has ed that pany founder Chairman Amar will unveil he believes is a utionary car- ension system. has been ing secretly for ast decade on a to smooth a le's ride. Bose won't l the details until late ıst, after the patents have filed.



BOSE
From stereos to suspensions

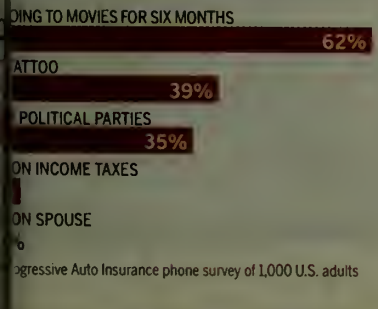
The mercurial Bose, 75, has astonished rivals before with products in previously unheard-of segments, such as the $349 Wave radio. Still, at first blush, auto analysts are skeptical. "Bose is incredibly strong in audio, but it could take years to achieve any recognition if it wants to be a player in engineering of the car," says Tom Libby of **Power Information Network.**

A suspension success would strengthen an already humming business: Privately held Bose had $1.6 billion in sales last year, a 23% gain from 2002. Surveys from **J.D. Power & Associates** show that Bose is the brand that consumers link most often with superior sound quality. So if Bose's idea has merit, auto manufacturers will be all ears. *–David Kiley*

E BIG PICTURE

YTHING FOR MONEY? Even $500, people are not that ly to engage in outright nonest behavior:

NTAGE OF PEOPLE WHO WOULD:



ogressive Auto Insurance phone survey of 1,000 U.S. adults

LABOR NOTES

Up Against The Wal-Mart

LABOR UNIONS have come up with a creative new approach for targeting **Wal-Mart Stores:** a 527 independent political committee, like the ones Democrats have been using this year to circumvent campaign-finance restrictions. At its August meeting in Chicago, the AFL-CIO also plans to form a committee of union presidents to combat the country's largest employer. Labor will sink several million dollars and a staff of a dozen or so into the 527, which will coordinate disparate anti-Wal-Mart groups, including anti-sprawl activists, living-wage campaigners, religious groups, and, of course, unions, says **United Food & Commercial Workers** (UFCW) President Joseph Hansen.

The idea is to create a clearinghouse for information about the retailing giant to get all these groups to work together. "It now seems they [the UFCW] have found an innovative way to pool their money and spread more lies tax-free," says a Wal-Mart spokesperson. The question is, will a broad political approach be any more successful than labor's many failed attempts to unionize Wal-Mart workers? *–Aaron Bernstein*

UPFront

THE DEAL MILL

HELLO, TYCO? TATA CALLING

TYCO INTERNATIONAL may soon sell its global telecommunications network. A number of potential buyers, led by the telecom unit of India's **Tata Group**, have emerged to acquire the company's web of undersea and overland wires, *BusinessWeek* has learned.

Chief Executive Edward Breen Jr. began shopping the network around last November as part of his restructuring plans. Tyco has hired investment bank **Goldman Sachs** to auction off the business, which includes transatlantic and transpacific cables and lines across Europe and the U.S.

BREEN Auctioning off Tyco's cables

Tata appears to be the most interested in buying Tyco Global Network, which was valued at $3.5 billion during the height of the telecom boom in the late '90s, according to a source close to the matter. Tata is considering a price in the low "$200 million range," the source says. Tata's telecom unit, India's incumbent international phone company, has lots of inbound capacity. But it lacks outbound bandwidth—a gap that Tyco could help fill.

Pivotal Private Equity in Phoenix also has shown keen interest in Tyco Global. Pivotal owns Internet domain pioneer **Network Solutions** and has been acquiring telecom assets of late. Other interested parties include **Reliance Infocomm**, which provides telecom services in India, and **Trinity Ventures**, a private equity firm in Menlo Park, Calif. **Singapore Technologies** also is interested—but has its hands full with a troubled **Global Crossing** acquisition.

As for Tyco, it has had enough of the undersea-cable market. Such cables were basic to the go-go strategy of the Dennis Kozlowski era, but Breen will no doubt be glad when this Tyco chapter is over. *–Steve Rosenbush*

DRIVE TIME

VROOM Time to test-drive that new...watc TAG Heuer, the world's fourth-largest watch maker, has developed a timepiece with a movement consisting of belts and pistons similar to an automobile engine. The officia Indianapolis 500 timekeeper claims the Monaco V4 Concept Watch is an innovative leap beyond quartz crystal-based models because it doesn't require batteries, or maintenance, to keep it ticking accurately. T Monaco V4 retails for $8,000 to $12,000, o about the price of a Saturn Ion. TAG Heuer hopes to use the technology in watches aim at a broader audience over the next 18 mon No word yet on gas mileage. *–Seth Po*

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FACE TIME

BRUCE NELSON

OFFICE DEPOT GOES ON THE ATTACK

The office-supply superstore wars are heating up. On June 30, Bruce Nelson, CEO of Office Depot, launched an aggressive expansion program, including a spiffier store design and a major invasion of the Northeast, territory dominated by rival Staples. Then, on July 13, Depot teamed up with Hewlett-Packard to offer the nation's first in-store recycling program for unwanted electronics such as old PCs. The program runs through Sept. 6, but Nelson hopes to extend it.

Nelson, 59, has kept Depot a leader in delivering office supplies. But he has played catch-up to Staples in superstores. Depot has 900 superstores in North America, compared with Staples' 1,400. To close the gap, he plans to open 100 new stores in each of the next three years. Nelson, who shuns such distractions as serving on outside boards, is ready for a long fight. "I haven't even thought about retirement." He's too busy trying to catch Staples.

–William C. Symonds

SPORTS BIZ

SENIOR WOMEN PLAY GOLF, TOO

TEED OFF Women golfers, including Stephenson, want a senior championship

WHO'S THE NO. 1 senior golfer in the world? Among men, it's arguably the champ of the U.S. Senior Open, the annual tourney for graybeards 50 and over that begins on July 29 in St. Louis. But the top golden oldie among women players? Don't ask the **U.S. Golf Assn.** The august USGA, which puts on the men's U.S. Senior Open, doesn't hold a senior open for ladies.

That's a slap, say some top women players. A small group, led by Jane Blalock, a star on the LPGA tour in the 1970s, is prodding the USGA to stage a ladies' senior open. It's about time, the advocates say, given that the Senior Open for men got its start in 1980. Blalock has written to USGA Prez Fred Ridley, but she hasn't met with USGA officials yet. Jan Stephenson, another vocal supporter and the 1983 U.S. Women's Open champ, also is sounding off. "It's very frustrating. We just want them to listen to us," says Stephenson, 52.

Doubters question whether a women's senior open would excite fans and sponsors. There's also debate about whether women golf champs 50 and over are plentiful enough to hold a national championship. Such concerns are off-base, claims Blalock, 58, president of the fledgling **Women's Senior Golf Tour,** now in its third year. "We have star power, an could draw," she says.

The USGA has been cr ing female champs since Barnes won the Women's Amateur Championship i 1895. The Senior Open is only USGA tourney, witho female counterpart. Ridle says a women's senior op an issue that he's "taking seriously." Chances are th USGA will get even more serious when Nancy Lope the queen of ladies' golf, t 50 in 2007. *–Mark Hy*

MEDIA MANIA

A RISING TIDE OF *EDICIONES ESPANOLAS*

MEDIA COMPANIES are learning Spanish faster than you can say *rápido*. On July 26, San Antonio's **Meximerica Media,** with backing from **Pearson,** launches *Rumbo*, the first of four tabloids aimed at Texas Latinos.

Rumbo has sparked other Texas papers to put out Spanish offshoots recently, such as the *Houston Chronicle*'s *La Vibra*. Also, **Washington Post Co.** announced plans to buy *El Tiempo Latino* in May, and **Tribune Co.**'s *Hoy* expanded to Los Angeles in March.

No wonder: Ad revenues at Spanish-language papers outgrew the general market and hit $854 million last year, says **Latino Print Network.** With the U.S. Latino population growing 3% each year, vs. 0.8% for everyone else, the fight for its readers is only going to become more *picante*.

–Brian Grow

THE STAT

36

The percentage of eligible 18- to 24-year-old voters who actually voted in 2000, compared with 51% of the overall eligible votin population

Data: Election Commission

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CELEBRATING 75

As part of its anniversary celebration, BusinessWeek *is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. In late September, 2004,* BusinessWeek *will publish a special commemorative issue on Innovation.*

The Light Fantastic

THE STORY OF THE LASER begins with some eye trouble. It was 1937, and Charles H. Townes, a first-year grad student at California Institute of Technology, faced a tough decision: pursue theoretical physics, a field then electrified by Einstein's ideas, or go into experimental physics, where he would build machines to test theories.

"My eyes were bothering me," Townes recalled in a recent phone interview. "A doctor said it was all the reading I was doing." Working with instruments instead of formulas, he figured, would save his sight. That choice took him down a path others had overlooked—one that led to devices that emit brilliant beams of light. "Initially, many theoreticians do this was possible," he says, including Niels Bohr and computer pioneer John von Neumann. Townes patented laser in 1959 and won a Nobel prize five years later.

He was educated in the presence of greatness. At CalTec Townes rubbed shoulders with J. Robert Oppenheimer, No laureate Linus Pauling, and a half-dozen other future Nob winners. With a newly minted PhD, he toiled during the w years at Bell Labs beside transistor co-inventors William B Shockley and Walter H. Brattain, developing early radar sys

Townes joined Columbia University's faculty in 1948 to research how microwaves might help reveal the structure o molecules. All he really sought was a new scientific tool, but what he invented revolutionized science. In 1951 he realized stimulating molecules with microwaves—and amplifying tl effect in a special chamber—could trigger a chain reaction leading to the emission of an unusually pure, concentrated beam of radiation. Thr years later, Townes and grad students fired up a machine that produce desired beam. They cal it a MASER, for microw amplification by stimul emission of radiation. Townes shared the 196 Nobel for it with two Sc scientists who were doi related research.

Lasers have transformed medicine, computers, telecom, and electronics

In 1958, Townes an his brother-in-law, Arthur L. Schawlow, adapted h theory to show that visible light could replace microwaves. But the first lasers were built by othe and Townes's laser patent was later challenged by ex-student, Gordon Gould.

At 89, Townes is still doing research—and his ey are just fine. In recent years he has focused on astronomy, using lasers to help combine images fr distant telescopes, effectively creating a huge virtu lens. Although the killer applications didn't materializ for many years, his lasers have transformed medici telecommunications, consumer electronics, and computing, and they're part of the emerging toolki for nanotech. Laser surgery, Townes notes, has eve saved the sight of some of his friends. ■

–By Adam A.

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"The networks . . . should try . . . limiting commercial breaks . . . and it wouldn't hurt to increase the quality of the programs"

–Laurence Feldman
Highland Park, Ill.

MASS MEDIA: KILLING THE GOOSE THAT LAYS GOLDEN EGGS?

THE TV NETWORKS have been responsible for slowly strangling the goose that lays the golden egg in terms of diminishing consumer audiences and skipped commercials ("The vanishing mass market," Special Report, July 12). If you are of a certain age, you can recall when commercials on network TV were limited to nine minutes per hour and when networks and stations avoided placing competing products during the same commercial break. Now commercial time on the networks, including promos and supers, is almost double that, and the product has been cheapened by reduced news coverage and reality shows. To rise above the clutter, many advertisers have resorted to noise instead of product "news."

The networks bemoan such things as the use of TiVos—yet they raise prices as the market for their product (network advertising) diminishes. Instead, they should try a new approach, such as limiting commercial breaks or restructuring programs so that commercials appear only at the end of the programs. Oh, and it wouldn't hurt to increase the quality of the programs themselves, thereby providing an environment in which adver products can be showcased.

–Laurence Fe
Highland Pa

Editor's note: The writer is pro emeritus of marketing at the Univer Illinois at Chicago.

PERSONALLY SICKENED BY the g advertising slogans and icons whic infested every walk of life, it sent a down my spine to read of the co strategies being devised to target sumers, particularly those of the tee young adult demographic. TiVo di blossom simply because of people's to record programming when n home. VCRs have effectively done job. The enticement was to skip con cials. When McDonald's Corp. or Cola Co. resorts to product placeme not because the masses are too bu pay attention to conventional TV It's because the masses intentic wish to avoid it.

As companies continue intrudin consumer "safe zones" reasonabl pected to be free of corporate mark more people will not only turn c those companies specifically but

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CORRECTIONS & CLARIFICATIONS

"Sarbanes-Oxley: Time to step up" (Editorials, July 19) quoted data from a survey on corporate implementation of financial controls that came off a Web site thought to be from the Public Company Accounting Oversight Board (PCAOB). The PCAOB says it has done no corporate survey on compliance. We have now learned that the domain name, "Sarbanes-Oxley.com," as well as the domain names PCAOB.COM and PCAOB.ORG, are registered and owned by Karl Nagel & Co., an accounting firm selling compliance services to corporations. Karl Nagel takes no responsibility for the survey. *BusinessWeek* tried unsuccessfully to find the author of the survey. The PCAOB is disputing the domain names with Karl Nagel & Co. In retrospect, we should not have used the data.

"Diseases in your future" (UpFront, July 26) got a Web site wrong. The correct address: www.yourdiseaserisk.harvard.edu/

"The benefits trap" (Cover Story, July 19) should have said that it was a Congressional increase, not decrease, in the interest rate used to calculate pension liabilities that caused those liabilities to decline. It also should have said that Bethlehem Steel was located in Steelton, Pa. (not Stilton). And the table supplied by UBS Investment Research, which ran on page 71, was based on faulty data. Two companies, AES and Allegheny Technologies, should not have been on the list. The 2003 pension deficit as a percentage of market capitalization for Delta Airlines should have been 387.9%, for Ford Motor 39.9%, and for Hercules 27.3%.

avoid the outlets to which the ads have attached their barnacles, i.e. network TV, sporting events, etc.

–Daniel Sandler
Boca Raton, Fla.

WITH MORE MEDIA OPTIONS than ever, which should have improved segmentation, advertisers now find formulaic media. Clear Channel Communications Inc. radio stations sound the same in Portland, Ore., as they do in Portland, Me. The same is true for network and local news, magazines, and newspapers.

The great copywriter Howard Luck Gossage predicted that when the revenue from advertising exceeded the revenue from subscribers for print publications, the content wouldn't be worth paying for. Forty years later, we're paying the price, with media outlets fearing to offend the advertisers, or, worse yet, their corporate master's stock price by doing anything that different from the next guy.

When your product becomes homogenized, it loses value to the advertiser faster than it does to the consumer. Now advertisers are forced to think smarter about how to connect. In this new world, formulaic media aren't going to cut it.

–David Esrati
Dayton

PUTTING TEETH INTO THE GLOBAL COMPACT

KOFI ANNAN'S PLAN on corporate social responsibility ignores the lessons of the successful Sullivan Principles that rallied corporate opposition to apartheid in the 1980s ("Global Compact, little impact," Social Issues, July 12). The Reverend Leon Sullivan focused on what the signatories were doing, not how many of them there were. His code was in sync with the logic of the private sector: Companies were rated against each other on a curve, the same way they were judged in the marketplace. They received an A, C, or a flunk. Performance, not plans and promises, was measured. Grades were public, and activists used them to pressure the laggards. The standards for acceptable social responsibility were ratcheted up each year, too.

–Robert Tomasko
Washington

THE 10 PRINCIPLES enumerated in the Global Compact document are themselves ambiguous and arbitrary. While well-intentioned in its proclamation against human-rights abuses, the use of generalized standards requires all member to decide for themselves their own global moral compass and universal ethical application system.

In the end, it will be the worldwide consumer that acts as judge and jury of commercial compliance to human-rights violations—as the venerable U.N. is always loath to take any action by itself.

–Lawrence A. Beer
Paradise Valley, Ariz.

A VOTE FOR NO CHILD LEFT BEHIND

MILLIONS OF TEACHERS are working hard—and honestly—to improve education under No Child Left Behind ("A spate of cheating—by teachers," Social Issues, July 5). Here's the real story about cheating: Since 1965, the federal government has spent $321 billion on education, with virtually no improvement in academic performance, thus cheating the taxpayers. And the American Di Project has reported that for too students, the high school di "serves as little more than a certifi attendance." So millions of our ch have been cheated out of their educ

Business Roundtable believes th Child Left Behind will help to tu around by raising standards, insist proficiency in reading and math, c the achievement gaps that have hel the poor and minorities, and h schools accountable for results.

–John J. Castellani, Pre
Business Roun
Wash

THE BUSH ADMINISTRATION ISN'T IGNORING CLIMATE CHAN

"STEALING A MARCH on the EPA" torials, July 12) falsely asserts that c change is not a high priority for the Administration. In fact, the U.S. cu spends more money ($2 billion ann on studying the causes and effects mate change than Japan and the Eu Union combined. The Bush Admin tion was the first to deliver a strategi as part of its Climate Change Scienc gram—which brought together 13 f agencies, more than 1,200 scientist stakeholders, and 35 countries arou world— even though Congress re such a plan in 1990.

Implementing policies designed t "global warming" has dramatic c quences for businesses large and and on the economy in general, what effect? Quite simply, we don't enough about climate change to u stand what effect policies would ha the global environment. That is why ident Bush's comprehensive plan to f in the gaps in climate-change know along with accelerating federal i ments in advanced energy technol such as the President's Hydrogen Fu tiative, is the most prudent course to

–Conrad C. Lautenbac
Vice-Admiral, U.S. Navy
Under Secretary of Commer
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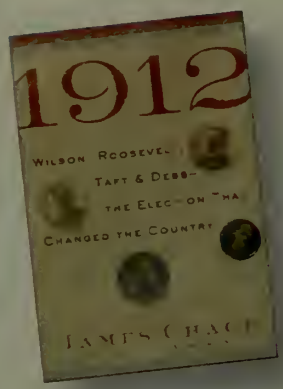

CA is pleased to offer you a chance to win *1912: Wilson, Roosevelt, Taft & Debs — The Election That Changed the Country*, a book recently reviewed in the pages of *BusinessWeek*. Visit **businessweek.com/bookgiveaway** to win one of the 100 copies being given away this month.

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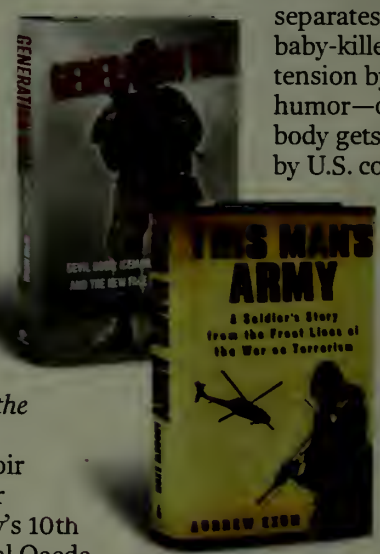
Fresh Killing Fields

GENERATION KILL Devil Dogs, Iceman, Captain America, and the New Face of American War By Evan Wright; Putnam; 354pp; $24.95

THIS MAN'S ARMY A Soldier's Story from the Front Lines of the War on Terrorism By Andrew Exum; Gotham Books; 239pp; $25

If you have felt frustrated by the U.S. media's sanitize coverage of war, be careful what you wish for. Evan Wright's *Generation Kill* and Andrew Exum's *This Ma Army* provide raw, immediate, and at times disturbin graphic alternatives, putting the reader smack on the front lines of combat.



Generation Kill: Devil Dogs, Iceman, Captain America, and the New Face of American War, written by *Rolling Stone* contributor Wright, tells everything you ever wanted to know about the experiences of the weapon-caressing, testosterone-charged, hip-hop generation of grunts in Iraq. Exum's *This Man's Army: A Soldier's Story from the Front Lines of the War on Terrorism* is a personal memoir of a college-educated warrior who, as part of the U.S. Army's 10th Mountain Div., chased after al Qaeda fighters in Afghanistan. Both books are intense and well-written.

As a reporter who covered the Iraq War while embedded with a unit well back from the front lines, I'm in awe of what Wright chose to endure. Traveling with the U.S. Marines of the First Recon, Wright was at the very tip of the U.S. combat spear in Iraq—in a group charged with racing ahead of the main U.S. fighting force to find the enemy. This sometimes meant deliberately driving into suspected ambush points.

At first, for the young Marines, the real-life danger and excitement beat any video game. The soldiers seem to feel both a giddy guilt and an "uneasy exultation in having committed society's ultimate taboo"—slaughtering other human beings. But after days of relentless fighting and mounting battle stress, the high wears off. As the Marines increasingly realize that more and more of their victims are civilians, including women and children, they begin to understand that a very thin line separates the hero from th baby-killer. Some deal with tension by resorting to gal humor—one dead Iraqi wh body gets repeatedly run o by U.S. convoy vehicles is nicknamed "Tomato Man." Others channel their feelings in sudden acts of compassion, as when some ber the rules in ord medivac out a wounded 12-ye old Iraqi boy.

The strength *Generation Kill* Wright's unflinching attention to de even when it casts U.S. combatants unfavorable light. One jittery grunt comes close to bayoneting a prisone before being stopped by fellow Mari There are extraordinary displays of incompetence on the part of officers when one orders a nighttime clearin land mines and a soldier loses half a Later the lack of a common radio frequency among some units leaves Marines powerless to prevent anothe unit from firing on defenseless civili At the book's conclusion, just days a the toppling of Saddam Hussein's statue, Baghdad has already begun t descend into chaos, prompting one platoon commander to comment tha the military's impact on establishing order is "just about zero." Sadly, tha observation still rings true.

While most of the grunts Wright travels with say they come from the segment of America where NASCAR racing is a kind of religion and readin books is for sissies, Andrew Exum co

decidedly, even self-consciously, ry. An upper-middle-class essean who majored in English and ics at the University of Pennsylvania, n spends the first third of his book icling his transformation from Ivy uer into alpha male trained to kill. though he does his best to hide his eged upbringing from the men, in he does nothing to mask his ry ambitions. Exum laces his prose liberal references to the likes of DeLillo, Vladimir Nabokov, and am Greene. Indeed, he is an able teller, providing a compelling icle of the extraordinarily harsh ing of the Rangers School. If the has one flaw, it's Exum's obsession his own physical prowess.

In March, 2002, Exum's platoon was dropped by helicopter into Afghanistan's Shah-e-Kot Valley to hunt Osama bin Laden's forces. Although he saw far less action than Wright's marines did in Iraq, he does describe shooting an al Qaeda fighter at close range. His first reaction, Exum admits, was "more amazement than horror. Actions unleashed by my hand had ended the life of this man."

It's unlikely that either of these books deserves to be shelved alongside such combat classics as Stephen Crane's *The Red Badge of Courage* or Michael Herr's Vietnam account, *Dispatches*. But for anyone wanting to grasp the experience of the trigger-pullers in today's U.S. military, these volumes are a must. ■

–By Frederik Balfour

Brief

ttle Big Man

AGE OF NAPOLEON

stair Horne; Modern Library; 218pp; $21.95

ll Clinton, eat your heart out. By t count, there are more than 00 books on Napoleon Bonaparte, elf a product of a hard-up family the South and the object of a vast, -wing conspiracy. Now, Oxford rian Alistair Horne has added a , highly entertaining volume to the *The Age of Napoleon* is a tonic for wanting to rejuvenate their History ray matter.

en make history, Karl observed, but not r conditions of their choosing. So it was with Napoleon: If it were not e waning of utionary ardor in ce, the inept and dent reign of the torate, and the ssity of combating pean armies, he would r have come to power. But in 1799, itions were ripe for a *coup d'état*, and eral Bonaparte reluctantly stepped the breach, becoming dictator and, 04, Emperor.

n the other hand, Horne suggests, leon's distinctive personality was his most enduring works, which largely nonmilitary in nature. ng with the same speed and kable concentration of energy that characterized all his military operations," Bonaparte set the country's finances in order, began rebuilding Paris and providing it with a modern water supply, placed secondary schools under state supervision, and took the first steps toward a new, widely influential legal system—the Code Napoléon. Such achievements, which left "an impact far beyond the frontiers of France," are a primary focus of *The Age of Napoleon*.

Horne, author of numerous previous books including *Seven Ages of Paris* (2002), also provides a portrait of French society. The urban poor still lived as miserably as under the *ancien régime*, and in 1806, as many as 75,000 prostitutes roamed the Paris streets. The army was able to absorb only a fraction of the unemployed, and, by 1810, desertion had soared, swelling the criminal underclass. Meanwhile, the well-connected, such as diplomat Talleyrand, enjoyed "scandalous" opportunities for enrichment. Not even the distraction of military glory was sufficient to contain public discontent: With the Empire at its peak, "street-corner assassination" by secret police held people in line.

All in all, *The Age of Napoleon* draws an insightful sketch of an age and of an archetypal political character—opportunistic, talented, hubristic, and ruthless. He's a figure we still know well. ■

–By Hardy Green

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Proactive

BY LARRY ARMSTRONG

Presto! Your Desk Phone Is a Cell Phone

You never want to be out without your cell phone, but what happens whe you get home? You leave it on the front seat of your car, park it with your keys and coins on top of the dresser, or plug it in someplace to recharge. Then it rings, and you go racing through the house looking for it before your caller gets redirected to voicemail. There's a better way. I've been playing around with a gadget designed to let you reap the benefits of your cell plan from your home phone. Called Dock-N-Talk, it's made by a tiny company called Phone Labs Technology Co. There are about as many options as a Lego set for hooking it up, but the basic idea is that it links a regular corded or cordless phone with your cell phone to provide the best features of each.

That means that you can use a regular phone to make and receive cell-phone calls—a great thing if you find today's tiny cell phones hard to hold or if you're worried about the radiation they give off. The system offers a nifty solution to dead zones in your house where your cell phone doesn't work. And you still have all the freebies on your cellular plan: long distance, family calls, and off-peak minutes, not to mention voice dialing and voicemail.

For the simplest configuration—turning one desk phone into a cell phone—I plugged the $140 silver box, about four inches square, into a electrical outlet in a room with good cellular reception. Using the phone cord that comes with it, I plugged the box into my desk phone, which was no longer jacked into the wall. Then I hooked Dock-N-Talk up to my cell phone. (For this last part, you need a $15-to-$18 adapter cable, and Phone Labs has them for more than 150 different Nokia, Motorola, and Sony Ericsson models.)

LINKED Dock-N-Talk (right) with home and cell phones

SURE ENOUGH, NEXT TIME A CALL came in on my cell, it rang on the desk phone. I could use that phone to place calls as well. I just dialed as I would on a landline, and the call went out over Cingular's cellular network. As for dead zones, just make sure Dock-N-Talk is anchored in a room with decent reception, then use a cordless handset anywhere in the house.

How about landline and cell service on a single phone? For that, hook Dock-N-Talk up to a two-line phone, with the other line plugged into a wall telephone jack. I used a Uniden TRU8866, a new two-line cordless phone that costs about $150. That g me a handset that I can take all ove the house and make or answer calls either over the cell network or my home line from the same handset. when I added Phone Labs' $70 Bluetooth module and synced it wit my cell, I moved up to yet another l in home telephony. Now, when I pu into the garage, I leave my phone ir car but still have cell service in the house. How cool is that? Phone Lat in fact, is going to start selling a $2 two-line desk phone, called Unity Phone, in late August, with the Doc N-Talk technology built in.

I also tried a product called CellSocket ($140) from WHP Wireless that does much the same thing as Dock-N-Talk. It uses a docking cradle instead an adapter cord, but it only w with some Motorola models, its voice quality isn't as good.

You can have landline and cell service from all the phone jacks in your home

But wait, there's more. It's little-known secret that most houses are wired with four-wi telephone cable, but a single telephone line uses only two wires. So your house probably already wired for a second line. Plug Dock-N-Talk, connec to your cell phone, into any phone jack and set its switch f Line 2. You'll have both landline and cell service from all t phone jacks in your house.

You see where this is going. Whenever you're ready, you can unplug your local phone company. ■

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BY JEFFREY E. GARTEN

Europe: Staring Into the Abyss

Since May, the European Union has incorporated 10 new members, presided over Europewide elections for the EU Parliament, agreed on a first-ever EU constitution, and appointed a new president of the Europea Commission. But no amount of political activity can camouflage Europe potentially dismal future. And because this region now accounts for a th of the world's gross domestic product, the problems besetting the EU could have as massive an impact on the world economy as the rise of China.

The EU's economic and social model is broken. It's not just that this past decade has been one of anemic growth and double-digit unemployment for the Continent, nor that projections are for a continuation of the same. More fundamentally, Germany, France, and Italy—which together account for over 60% of activity in the euro area—will be unable to compete with the U.S. on one side and China on the other. They are stuck in a time when it was an asset to have cozy banking relationships, permanent job security, and sky-high government-financed entitlements.

TODAY, EUROPEAN EFFORTS to develop knowledge-based economies with robust research-and-development programs and superior universities are nowhere near enough. Even though there has been some progress in slowing trade union demands, trimming expensive social programs, and liberalizing immigration policies (as occurred in Germany recently), deep-seated changes are much too slow in coming. Meanwhile, the combination of Europe's aging populations, declining birthrates, and rising fiscal deficits make America's challenge of financing Social Security look easy.

It's no wonder that high-tech companies such as Switzerland's Novartis have moved their R&D to the U.S. In mid-July, DaimlerChrysler threatened to cut 6,000 jobs and shift substantial production overseas due to high labor costs.

The biggest problem is the increasingly dysfunctional political environment. This summer has seemed like one long public brawl. Nicolas Sarkozy, France's Finance Minister, criticized the European Central Bank for high interest rates. EU Commissioner Frits Bolkestein attacked French and German government policies to prop up industries, such as pharmaceuticals and banking. The European Commission, the European Council, and the European Court argued over who sets fiscal rules.

In June, appallingly low turnout for elections for the European Parliament showed that voters are apathetic about the EU itself. Shortly afterward, EU leaders further damaged their credibility by agreeing to a dense 300-page constitut that ordinary citizens could not possibly understand. "Th has become too complex and too chaotic," said Victor Halberstadt, a professor of economics at the Netherlands' Leiden University and a longtime adviser to government corporate leaders throughout the Continent. "There are n viable national solutions and no effective supranational structures," he told me in an interview.

Claude Smadja of Smadja & Associates in Geneva, a strategic adviser to companies and government entities around the world, lambastes European politicians. "Th are cowards," he told me, "because they have not levele with European citizens about how dire their circumstan are. Europeans have been del into thinking that incrementa policy changes will work."

Soon, the EU may be unable to compete. Meanwhile, pols bicker

The upshot? We could well s gradual increase in European protectionism as the EU fails to become globally competitive. European governments could f the European Central Bank int dangerously loose monetary policies. Politicians on the extre right could become more attrac to highly frustrated citizens. Europe's capability to fight glob poverty or finance antiterrorist activities could diminish.

Europe needs a Margaret Thatcher-type revolution, sa Smadja. But given the political and cultural differences, one national leader could have the influence on all of the that the Iron Lady had on Britain, says Leiden Universit Halberstadt. "There is arising in Europe a sense of helplessness and hopelessness," he told me.

European integration was propelled by a vision of preventing European nations from ever again going to wa with one another. Now a compelling new rationale for a t European union is necessary. Sadly, none is in sight. ■

Jeffrey E. Garten *is dean of the Yale School of Management (jeffrey.garten@yale.edu).*

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BY JAMES MEHRING

OLD ECONOMY, NEW FLEXIBILITY

Manufacturers may be slower to spark inflation

EVERYONE IS ON THE LOOKout for signs of inflation. One gauge used by economists is capacity utilization. Rising demand causes factories to run more production lines for longer shifts. But bottlenecks and delivery delays can give manufacturers the opening to raise prices. A utilization rate above 83% has typically triggered concerns of budding inflation. But that rule of thumb may not be true anymore.

Technology has lowered the utilization rates at which factories can operate without facing production pressures, according to a discussion paper released by the **Federal Reserve.** The authors* examined data on 111 manufacturing industries from 1974 through 2000 and controlled for production growth and level of investment for each industry. They found that, as a result of new technologies put in place, capacity utilization rates fell 0.2 to 2.3 percentage points, on average, per industry.

FAR FROM THE DANGER ZONE

Data: Federal Reserve, Global Insight Inc.

How does technology allow for lower operating rates? According to the authors, declining prices for high-tech gear, such as computer networks, make it more cost-effective to keep excess capacity on hand until needed. In turn, excess capacity has given manufacturing new production flexibility. As a result, the authors say, it is "easier for firms to respond to a period of strong demand by boosting capacity in a timely way."

For inflation-worriers, the results suggest that it may now take a faster pace or a longer period of economic growth to push up operating rates to levels that spark inflation. So recent price spikes may well prove transitory as manufacturers adjust on the fly to gains in demand.

*Cynthia Bansak, San Diego State University; Norman Morin, Federal Reserve Board; Martha Starr, American University, *Technology, Capital Spending, and Capacity Utilization*, May, 2004

HEALTH CARE: TRUST ISSUES

The employer-worker credibility chasm

WHEN IT COMES TO health-care benefits, companies and employees just don't see eye to eye. A survey of both employers and workers by the human-resource giant **Towers Perrin** shows that many employees don't believe what their companies tell them about the growing pressure from soaring benefits costs. Out of 1,000 workers surveyed, half said they believe what their employers say about health costs, and only about a third think rising costs have any impact on the success of the company.

Employers and workers are also at loggerheads over how effectively benefits are used. Of the 120 large and medium-size companies surveyed, nearly two-thirds didn't think their staffs were conscientious health-care users or cared about making lifestyle changes that could lower health-care costs. That's one reason employers are passing along a greater share of the cost to workers. At the same time, 82% of workers believed they effectively use their health benefits.

Towers Perrin says the impasse is largely caused by poor communication. Most workers said their companies neither convey what it actually means to be a better consumer of medical care nor stress the benefits of personal health. Instead, by harping on higher costs, companies are fueling more resentment.

The study shows some opportunities for progress. For example, over three-quarters of workers said they would be willing to make positive lifestyle changes if given a financial incentive to do so. Yet until companies and workers narrow their perceptual differences and work together toward solutions, both workers and businesses will proba keep paying more for medical cove

LATINOS' EDUCATION GA

High-school dropout rates remain high

LATINOS ARE THE LARGES minority group in the U.S., 13.7% of the population in 2003—and the Census Bur projects 20% by 2030. So America's economic success increas will rely on how well future genera of U.S.-born Latinos improve their l Recent data show cause for concer

A **Federal Reserve Bank of Dallas** economist† looked at education level across generations and found the hig school dropout rate for Latino immi was 44.2% in 2001, vs. 7.4% for all no Latinos (table). The rate for offspring Latino immigrants falls to 14.6% but holds at 15.9% for following generati almost double the non-Latino rate.

Why the gap? Besides lower incor

Not Making the Gra

HIGH-SCHOOL DROPOUT RATES*	GENERATION FIRST	SECOND	THI
All immigrants	27.4%	9.4%	8.
Non-Hispanic	7.4	4.6	8.
Hispanic	44.2	14.6	15.

*16 to 24 year olds Data: National Center for Educat Sta

and a language barrier, "Latinos who contend with the low quality of schoo in many inner cities become discoura from pursuing a college education an sometimes from even finishing high school," says author Pia Orrenius.

Data show that the education divi accounts for two-thirds of the wage between third-generation Mexican-Americans and white U.S. citizens. S says the divergence can be reduced i Latino children get help early. One example: more English language programs that don't pull immigrant out of their regular classrooms. ■

†Pia Orrenius, *Immigrant Assimilation: Is the Still a Melting Pot?; Southwest Economy*, May/J 2004, Federal Reserve Bank of Dallas

AMES C. COOPER & KATHLEEN MADIGAN

hill Out: Inflation s Still Pretty Tame

enspan, despite some concerns, expects interest rates to rise gradually

U.S. ECONOMY For the first time in years, inflation is back on the lar screen. Be assured that recent blips are getting plenty of ention from the Federal Reserve, whose job it is to keep inflation der control. Almost all of the price indexes, from raw commodities wholesale finished goods to retail items and services, have risen r in the past year than they did in the previous year. esult, pressure on the Fed to tighten policy by g interest rates already is building.

t the aim is not to rein in an out-of-control economy. t, recent data suggest the economy is moderating its souped-up pace of late last year. Rather, the Fed's s to remove the unprecedented degree of policy nmodation that was necessary back when deflation d like a threat. Now the Fed wants to take policy to neutral—a level of interest rates that is neither nmodative nor restrictive to economic growth.

that end, the key question about monetary policy is ow much further the Fed will have to raise rates, already hiking the federal funds rate by a quarter-, to 1.25%, on June 30. Almost all economists agree ed will have to lift its funds target by as much as percentage points in the coming year or so.

e crucial question is how fast policymakers will have ve. Will the Fed be able to lift rates at its recently cted "measured pace," generally taken to mean a s of small quarter-point hikes? Or will it have to more aggressively? The latter approach could prove erous, since it could disrupt the financial markets harm the economy.

T'S WHY ALL EYES were on Fed Chairman Alan nspan on July 20-21 during his semiannual report to gress on monetary policy. As widely anticipated, nspan sounded a generally upbeat tone on the omy and inflation, suggesting that the Fed will be to move gradually.

hile recognizing that some degree of business on still lingers, Greenspan pronounced the recovery -sustaining," in no small part because of stronger job kets. And on inflation, the Fed chairman reiterated elief that some of the recent inflation pressures were itory, reflecting pricier energy and the indirect ct of more expensive energy on business costs.

hat was new in Greenspan's testimony was his ased attention to the possibility of more aggressive ening on the chance that current expectations for growth and low inflation are wrong: "We cannot be in that this benign environment will persist and that there are not more deep-seated forces emerging as a consequence of prolonged monetary accommodation."

In fact, Greenspan cautioned that some of this year's pickup in inflation may not be transitory, but that it could be related to stronger demand, which is a more fundamental and longer-lasting inflation factor. He predicted demand in the second half will bounce back from its spring lull. In particular, he said the softness seen in consumer spending will prove short-lived. Bond market players reacted negatively to Greenspan's slightly more hawkish caution: They pushed long-term rates higher on the Fed chief's remarks.

But Greenspan made it clear that his basic view of the inflation outlook was favorable. He argued that slack in the economy and intense competition will limit price increases. He said that, for now, unit labor costs are not rising fast enough to threaten price stability over the long haul. Plus, because profit margins are exceptionally high, he thinks businesses have plenty of room to absorb higher costs, without jacking up prices.

THE FED SEES BLUE SKIES AHEAD

FED'S CENTRAL TENDENCY FORECAST (4Q TO 4Q PERCENT CHANGE)

	2004	2005
REAL GDP	4.5-4.75	3.5-4.0
CORE INFLATION*	1.75-2.0	1.5-2.0
UNEMPLOYMENT RATE (4Q AVG.)	5.25-5.5	5.0-5.25

*PERSONAL CONSUMPTION EXPENDITURES PRICE INDEX EXCLUDING FOOD AND ENERGY

Data: Federal Reserve Board

THE FED'S OFFICIAL FORECAST, which is based on the central tendency of the policymakers' individual projections, sees nothing but blue skies. In a nutshell, the forecast is for solid economic growth, stable inflation, and a continued, gradual drop in unemployment (table).

One interesting implication of the Fed's forecast is that growth in real gross domestic product will have to speed up in the second half to meet the policymakers' projections. Such a view runs counter to the recent spate of economic numbers. The June reports on employment, retail sales, and industrial production, all looked weak. But the Fed's forecast suggests that the policymakers think the disappointing data overstate the degree of the economy's slowing. Indeed, the recent monthly trends of

all the key data appear much stronger, so the Fed's forecast might not be too far off the mark.

Take the latest news on June industrial production and housing starts. Industrial output fell 0.3% last month, after gains averaging 0.6% per month during the first five months of 2004. But reports on industrial activity in June and early July coming from the nation's purchasing managers and regional surveys have remained robust.

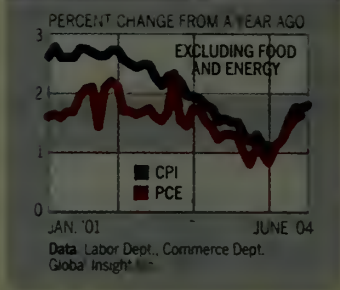
The stronger reports support the idea that production will rebound because many businesses still need to build up their inventories to meet demand. In May, the ratio of all business inventories to sales, a measure of the adequacy of stock levels, remained at a record low of 1.3, which is far below its long-term trend. Pressure to increase inventories will support future production gains.

In addition, June's 8.5% drop in housing starts, the largest fall in more than a year, also looks flukey. Mortgage rates have come back down in early July, and mortgage applications remain at a high level. Moreover, the July survey from the National Association of Home Builders shows that construction activity is solid.

ON THE INFLATION FRONT, Greenspan's belief that most of the price pressures in the first half will prove to be transitory appeared to gain support from the June consumer price index. Much of the acceleration in the price indexes this year has been fueled by rapidly rising energy prices. But the underlying trend in inflation, outside of fuel and food, is much tamer. Indeed, the core CPI, which excludes those two volatile items, rose just 0.1% in June from May, the smallest increase this y

Watching the CPI to decipher the Fed's intentio however, may be a bad game plan. The Fed now lo the core price index for personal consumption expenditures, which excludes energy and food. Th switched its focus from the overall PCE index to th PCE index because the core reading "i better as an indica underlying inflatio trends" than the o index. That means Fed is more concer with long-run patt than with the short gyrations that ener food can cause.

TWO PRICE MEASURES, BOTH MOVING HIGHER



Under the core index, inflation is running at only 1.6 the past year, up from 1.3% this time last year. By contrast, the CPI puts core inflation at a higher 1.9% from 1.5% a year ago (chart). No matter what core i you pick, the underlying pace is moving up.

The more critical point for the outlook, howeve that by any measure, inflation is far from exhibitin unruly behavior that would knock the Fed off its measured pace of tightening. The only way that co happen is if the economy turns out to be a lot stro than the Fed now expects. ■

U.S. LABOR MARKETS

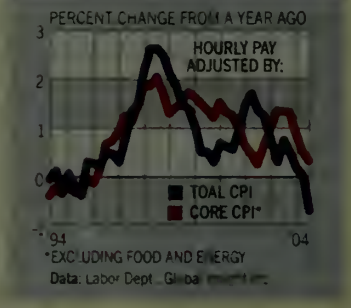
The Truth About Worker Pay

JUST HOW BIG IS the squeeze on the pay of American workers? The answer is not as clear-cut as the polarized views of each political camp would lead you to believe.

Labor Dept. data say the average hourly wage for production workers rose 2.1% in the year ended in the second quarter, well behind the 2.8% rise in the consumer price index. As Senator John F. Kerry (D-Mass.) would point out, that means real wages shrank 0.7%, the first drop since 1995.

But that weakness is not a sign of long-term problems. The fall is due partly to the swing of the business cycle and partly to this year's energy-led surge in inflation. The labor market still has enough postrecession slack to keep wage growth soft. But with job gains this year averaging 211,000 per month, the jobless rate will continue to fall, and pay gains will firm up in the coming year. And as the Bush camp would argue, with payrolls now rising, income from wages and salaries for all workers is already up a healthy 5.1% from a year ago, well ahead of inflation.

TWO TAKES ON REAL WAGES



What really knocked the wind out of buying power was surging energy prices, causing the yearly pace of the CPI to nearly double from March to June. But the first half's 28% jump in energy prices won't be repeated in the second half. True, oil, at more than $40 per barrel, remains costly. But if it just stays at that level, energy's contribution to the gro consumer prices will be negligi the price falls, so may inflation. Excluding the temporary swing energy and food prices, core infl is only 1.9%. By that measure, r wage gains have slowed but are positive (chart).

Most important, the long-run outlook for real wages is firmly upbeat for a reason that no polit can take credit for: the higher tr of productivity growth. That's th prime mover of real wages over t long haul. That's why, from 200 2003, a period comprising a rece and a jobless recovery, real wage managed to grow at an annual r 0.7%. That's in stark contrast wi previous recessions, when real w fell sharply. With overall inflatio to slow, and with job markets tightening, higher productivity assures that real pay gains will p up in the coming year. ■

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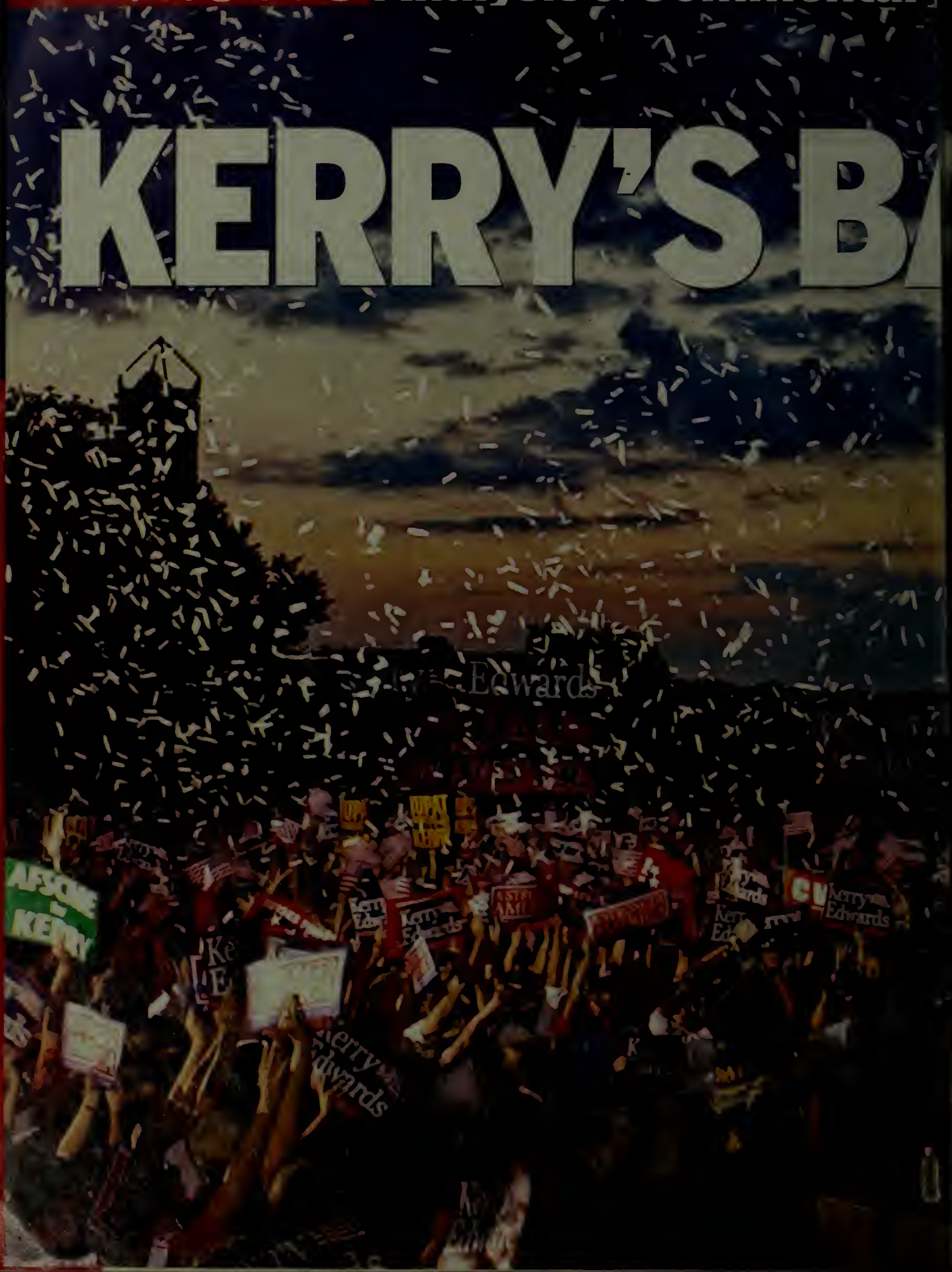
News Analysis & Commentary

KERRY'S B



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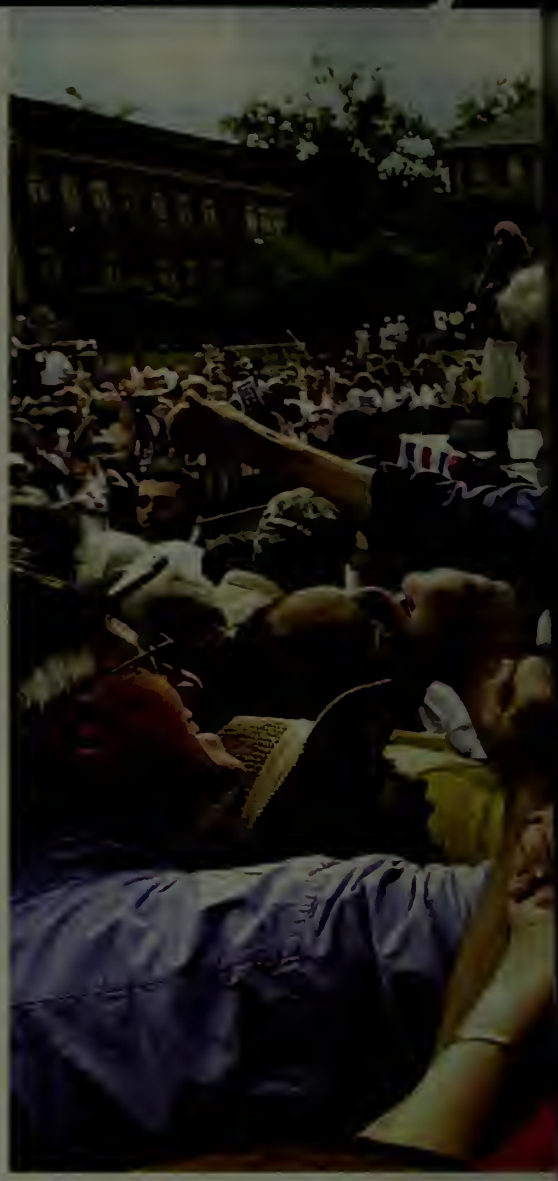
TLE PLAN

He can't simply rely on anti-Bush fervor to get elected. So he's out to ease the middle-class squeeze

CHARLESTON, W. VA. Despite such shows of support, Kerry remains an enigma to much of America

As he works on his speech for the July 26-29 Democratic Convention, nominee-in-waiting John Kerry can't help but marvel at his long, strange trip to the podium of Boston's FleetCenter. After a Lazarus-like revival from the back of the primary pack, the lanky Massachusetts senator has repeatedly surprised political sages. Kerry overcame a ponderous campaign style to unite his party, helped Dems shatter fundraising records (page 42), and has pulled ahead of a wartime President despite a growing economy.



Yet as he preps for his July 29 star turn, Kerry realizes that even a studiously centrist convention will still leave him a long way from his goal of the Presidency. Despite discontent with George W. Bush, a large swath of America feels it doesn't know enough about Kerry, his heart, or his soul to consider him as an alternative—yet. And much of what voters do know isn't flattering, thanks in part to a GOP ad blitz. In a July 10-13 poll by the liberal Democracy Corps, 60% thought Kerry would raise their taxes despite his pledge to limit the bite to the wealthy; 51% considered him too liberal.

Kerry needs to change such attitudes, starting with a makeover in Boston. But with the White House accelerating the military disengagement in Iraq, he also knows he can no longer count on voter disillusionment with the troubled U.S. occupation to clinch the election. So as attention shifts back to the economy, Kerry has renewed his emphasis on jobs and the "middle-class squeeze."

His agenda—a set of programs aimed at helping workers cope with rising health and tuition costs, the offshoring of jobs, and stagnant wages—is complex and pricey. It's also a sketchy blueprint that, should Kerry win the election, will almost certainly undergo radical surgery when the candidate confronts budget reality and what's likely to be a hostile GOP Congress. At its core is a grand bargain: Kerry offers a $650 billion health-insurance plan and $200 billion in education spending, to be financed by rolling back Bush's tax cuts for families earning more than $200,000—about 3% of taxpayers. That could free up some $600 billion to $860 billion—money the Dems feel could be better used to ease stress on working families and spur consumption.

But that would leave nothing for Kerry's pledge to slash the deficit. And if a GOP-controlled Congress balks at rolling back tax breaks for the wealthy, he would have to drastically scale down his ambitions, risking the ire of voters. Other potential problems: In addition to stripping the well-heeled of their top tax rate, Kerrynomics would hike their taxes on capital gains and dividends. Kerry sees this as a matter of fairness. But some economists worry that such moves could harm investor psychology and capital formation. "Cutting dividend taxes was the single most important thir publicans did under Bush," says A can Enterprise Institute economist A. Hassett. James C. Tyree, CE Mesirow Financial Holdings In Chicago money manager, backs m Kerry's tax ideas, but says: "For f growth, the capital-gains cut is criti

FORMULA FOR GROWTH

KERRY, HOWEVER, BELIEVES t away from the rich—who have propensity to save than average work

KERRYNOMICS: A SAMPLING

The plan hinges on raising marginal rates and rolling back capital gains and dividend tax cuts for families making more than $200,000:

HELPING THE AVERAGE JOE AND JANE

Kerry would cover 27 million uninsured Americans and cut health costs by shifting large claims to Washington. He also wants to boost tax credits to cover four years at a state college, fund after-school programs, and expand Family & Medical Leave.

BOLSTERING JOB GROWTH

By cutting the corporate tax ra 35% to 33.5% and offering a t to cover payroll levies in indus affected by outsourcing, Kerry keep more jobs at home. He w offer a tax holiday for compani reinvest overseas income in th

Data: Kerry for President

PHOTOGRAPH ON PREVIOUS PAGES BY GERALD HERBERT/AP/WIDE WORLD; LARGE PHOTOGRAPH ABOVE BY ROBERT WILLETT/NEWS OBSERVER/ZUMA PRESS

RALEIGH, N.C. Some execs worry that Kerry and Edwards will be protectionist

redirecting money toward "human ital" is a better formula for growth. "If re going to be competitive in the glob- conomy, we've got to dig out of our fis- hole, fix health care, and have a more ctive public education system," says ner Treasury Secretary Robert E. Ru- , a Kerry confidante. "If Kerry gets ted, he'd be terrific on these issues."

Yet an expansive new middle-class ety net would come at the cost of high- axes on affluent investors. While Ker- nsists that hitting up the rich to help the middle class is worthwhile, many economists fear it will harm long-term growth. "Raising taxes would have a decidedly negative effect on the economy," says Mickey D. Levy, chief economist at Bank of America Corp.

Few economists have put pencils to Kerrynomics' overall impact. One of the first studies, a forthcoming paper by forecasters Economy.com in West Chester, Pa., finds that diverting wealthy taxpayers' cuts to health care would boost growth slightly—by up to a quarter of a percentage point—in the first four years. But then, Kerry falls far short of his pledge to trim the deficit, and higher interest rates crimp growth after 2009. "The boost only works in the short term," says Mark M. Zandi, the firm's chief economist.

As Kerry has climbed in the polls, business anxiety has deepened. "Kerry has a good chance in the fall—but he has always had an anti-business voting record," frets Peter McCausland, CEO of Airgas Inc., a Radnor (Pa.) industrial company. Adds Edward M. Liddy, CEO of Allstate Corp. in Northbrook, Ill.: "If he wants to increase taxes, I think that's bad for the economy." But Kerrynomics is more complex than GOP caricatures, and Kerry's challenge now is to explain it to voters in a way they can quickly grasp. Among the key elements:

KERRYCARE The Democrat's top priority is a plan to expand health coverage while driving down premiums—not an easy feat. Kerry would extend government insurance for children and low-income workers. Small businesses that can't currently afford care could join a national pool to cover their employees. For all employers, the feds would take over the cost of catastrophic illness. Finally, Doc Kerry would use new technology to slash overhead and waste (page 38).

Some conservative economists applaud Kerry's decision to build on the employer-based system. But they fear that the government, in a giant shuffle, would be taking on a huge commitment without doing much to control costs.

KERRYKIDS Kerry wants to spend $200 billion over 10 years to bolster public schools, hike teacher salaries, and offer tuition help for families. His College Opportunity Tax Credit provides a $2,500-a-year break to help pay for college. He vows to spend $100 billion to fully fund Bush's No Child Left Behind Act, a law that mandated tough standards but, critics charge, didn't provide enough cash. "Kerry's

ATING THE RE WORKFORCE

ocratic contender wants to d the No Child Left Behind Act. ion, he would provide ory funding for all federal on policies and hike teacher in exchange for performance standards.

BOOSTING SCIENCE & TECHNOLOGY

Kerry would increase support for federal R&D and "critical technologies" in such fields as physics and biotech. He also backs tax credits to speed universal broadband access and would commit to a 10-year "Manhattan Project" aimed at energy independence.

REDUCING THE DEFICIT

Kerry says his upper-income tax hike will cover his health and education plans. Beyond that, he pledges to cut the federal budget deficit by half over four years by requiring new revenues to cover any spending increases and by imposing spending caps on domestic programs.

higher-education platform is critical," declares Chris Gabrieli, a Massachusetts venture capitalist. "For the first time, we are seeing a widening [income] gap on college accessibility."

But Kerry's education plans are under fire from both the Right and the Left. Republicans suspect that, in exchange for grassroots support, he will reward teachers' unions by watering down standards. "We need to stay the course on accountability," says Susan Traiman, an education expert at the Business Roundtable. "Resources alone won't fix schools." Others worry that Kerry shortchanges preschool programs and aid for poor children. "Middle-class programs are obviously more popular politically," notes Isabel V. Sawhill, a Brookings Institution economist. "But if kids fall behind early, they'll never catch up."

JOBS As the first U.S. leader since Herbert Hoover to preside over a net job loss during his term, Bush is vulnerable to charges that his policies have hurt working Americans. To spur job creation, Kerry proposes a tax credit for new hiring by manufacturers, small business, and companies affected by outsourcing. And he would end capital-gains taxes for investments held for five years or longer by some small businesses. But the record of targeted tax incentives is spotty. In practice, most of the cash ends up subsidizing jobs that would have been created anyway.

Kerry is also trying to slow the export of U.S. jobs to low-wage countries. He would end favored tax treatment of profits earned overseas by U.S. multinationals in an effort to encourage more outfits to locate in the U.S. That may sound unrealistic in a global economy, but Kerry offers two goodies to tilt the table. To entice companies to bring home profits earned abroad, he dangles a one-time reduced 5% tax on repatriated earnings. And he promises to cut the top tax rate for all corporations from the current 35% to 33.5%.

Kerry presided over a hot internal debate over this issue. More liberal aides eyeing funds for social programs objected to a business tax cut, but Kerry felt it was a smart symbolic move. "When was the last time a Democrat proposed cutting corporate taxes?" says top Kerry strategist Bob Shrum. "People like Ted Kennedy were saying: 'John, what are you doing?'"

If the gambit was supposed to please business, it flopped. Groups such the National Association of Manufacturers blast Kerry for hurting multinationals that already face stiff competition. "Kerry's proposal on foreign-source profits is upside down," says Dirk Van Dongen, president of the National Association of Wholesaler-Distributors. "It rewards high-cost companies." Adds Jon A. Boscia, CEO of Lincoln Financial Group in Philadelphia: "We have to walk a fine line between protecting jobs and impeding capital flows."

TRADE Business is agonizing over Kerry's "fair trade" policy—especially since he put North Carolina's John Edwards on the ticket. In the Senate, Kerry was a free-trader but now vows to fight "unfair" foreign competition. He would slap a moratorium on new trade pacts pending a 120-day policy review. He leans toward labor's call to reopen the WTO and NAFTA pacts to toughen worker and environmental protections. And he claims he'll confront Beijing over currency manipulation, in tual property theft, and dumping.

Amending NAFTA is largely sym however, because enforcement of standards is virtually nonexistent in developing countries. Bill Clinton en in a similar rhetorical exercise- proved his free-trade credentials by ing trade pacts through Congress.

Kerry, in contrast, is a que mark, and could easily rile with a raft of trade compl Scott Kriens, CEO of Juniper works Inc. in Sunnyvale, worries that under Kerry anc wards, the U.S. could "becom lationist and ignore global for

THE DEFICIT Kerry thinks a c ble plan to lower deficits wil downward pressure on int rates and reduce stress on ca markets. And he vows to lead b ample. In a July 16 talk with *nessWeek*, he said: "I am absol committed" to deficit-fighting pledged to trim his plans i comes up short of funds. "K will restore the policies brought prosperity in the '9 says adviser Roger C. Alt chairman of New York investr bank Evercore Partners.

How? Kerry vows to bring pay-as-you-go rules and spen caps that Congress let lapse. An has already scaled back his a states and education in respon GOP ads that claimed he w have to raise taxes by $1 trillio pay for his agenda. Like Bush pledges to cut the deficit in ha 2008. But also like Bush, his to do that is nebulous. "At best, is a treading-water scenario," Robert L. Bixby, executive dire of the Concord Coalition, a bud watchdog group.

Since neither candidate is sh ing much appetite for a fight to trol entitlements, Kerry and Bush n spin gossamer dreams of another ma boom—and with it, a revenue-gusher lifts all boats. "I believe we can ha tech boom again," Kerry insists.

But will we see a reprise of the Roa Nineties? The huge corporate inv ment in info tech that underpinned boom may be behind us. What's m with defense spending rising, sopping the red ink will be harder than us "The most striking thing about Ker agenda is that it's not Rubinomics," s Andy Laperriere, managing director of ternational Strategy & Investment Gr

BETTER OFF NOW THAN FOUR YEARS AGO?

From 2000 to 2004, households have been hit with rising costs. But they have also made some gains:

WORSE OFF	BETTER OFF
PERCENT CHANGE	PERCENT CHANGE
GALLON OF GASOLINE +23%	NOMINAL MEDIAN FAMILY INCOME +8%
HEALTH-CARE PREMIUM FOR FAMILY +49%*	MONTHLY PAYMENT ON $250,000 30-YR. MORTGAGE −20%
	PERCENTAGE POINT CHANGE
TUITION, FOUR-YEAR PUBLIC COLLEGE +40%	AVERAGE FEDERAL INCOME AND PAYROLL TAX RATE −2.3
DAY CARE AND NURSERY SCHOOL +19%	REVOLVING DEBT AS PERCENT OF AFTERTAX INCOME −0.5
PROPERTY TAXES +30%	OVERALL INFLATION RATE −1.5

* 2000-2003 **Data:** Commerce Dept. National Association of Realtors, Energy Dept. Kaiser Family Foundation, College Board, Labor Dept., Tax Policy Center, Federal Reserve

an institutional broker. "He's claim- Rubinomics without having a plan." erryites reply that they would be fools oll out detailed budget cuts in the st of a campaign. Still, supporters be- he'll deliver—if only to pacify the kets. Says media mogul Barry Diller, of IAC/InterActiveCorp.: "I have vn Kerry for 20 years, and I don't k he will run an Administration that ything but centrist."

cautious pol by nature, Kerry is un- v to launch a spending spree. But in- rs rattled by talk of hiking top- ket taxes on capital gains and lends still worry that he might yank e spark plugs of growth. A new study University of California at Berkeley omists Emmanuel Saez and Raj ty found that dividend payouts rose ply after the 2003 tax cut. And Zandi ulates that Bush's cap gains and divi- d cuts fattened stock prices by 5%. et there's little hard evidence so far Bush's investment tax cuts boosted capital spending or economic growth. So Dems insist repeal won't be a downer. "There is no established link between capital-gains tax cuts and growth," says Kerry supporter Laura D. Tyson, dean of the London School of Economics and a *BusinessWeek* columnist.

The bottom line on Kerrynomics? If elected, Kerry would put most of his limited chits on a bruising battle to swap top-bracket tax hikes for better health care. Other initiatives would fall by the wayside if a GOP Congress balks. On protectionism, Kerry-watchers wager that his bark is worse than his bite. And many budget experts suspect that given his domestic ambitions, he'll do more to shift the composition of federal spending than to trim it with an aggressive war on waste.

The result could be a standoff in which Republicans act as a check on Kerry's middle-class dreams. "Wall Street is beginning to think that this guy might win," says Gregory R. Valliere, managing director of Schwab Washington Research Group. But is there panic at the intersection of Wall and Broad Streets? Hardly. "If he wins, we will have gridlock. That's not bad at all for markets," says Valliere.

Kerry isn't fazed by such predictions. He vows to rally voters, Arnold Schwarzenegger-style, to sweep out Republican obstructionists. "If these people resist, I'll go to the country, and we will have that fight in the midterm elections," Kerry vows. "That's what leadership is about." John Kerry as political Terminator? Stranger things have happened. ■

–By Lee Walczak, Richard S. Dunham, Mike McNamee, and Howard Gleckman, with Rich Miller and Alexandra Starr, in Washington, William C. Symonds in Boston, Amy Barrett in Philadelphia, and bureau reports

BusinessWeek online For interviews on Kerrynomics with Clinton Treasury Secretary Robert E. Rubin and former Bush economic adviser Lawrence B. Lindsey, log on to www.businessweek.com/magazine/extra.htm

TEAM

rry's Key mestic visers

ROGER C. ALTMAN

Investment banker, chairman, Evercore Partners

BACKGROUND Former Deputy Treasury Secretary in Clinton Administration

ROLE Helps shape tax and budget plans while drumming up CEO support for the Democratic ticket. Bounces Kerry's staff proposals off Wall Street to see how they'll play there and in Corporate America. Could become Kerry's Treasury Secretary.

ROBERT E. RUBIN

Chairman of the Executive Committee, Citigroup

BACKGROUND Treasury Secretary in Clinton Administration

ROLE Eminence grise lends Wall Street credibility to Kerry's economic plans. Campaign seeks his blessing on major initiatives. Kerry hopes that Rubin's reputation for fiscal probity will help sell Kerrynomics to skeptical CEOs. Could be named the next Fed chief.

GENE SPERLING

Policy expert, Council on Foreign Relations and Center for American Progress

BACKGROUND Directed Clinton's National Economic Council

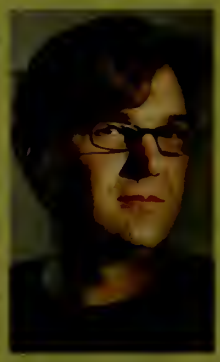
ops for new ideas among ocratic Establishment and an New Democrats. A workaholic o could wind up heading e of Management & Budget.

SARAH BIANCHI

Policy director, Kerry campaign

BACKGROUND Al Gore's campaign issues chief

ROLE Coordinates work of 200 outside economists and 37 domestic-policy task forces. A health-care expert with roots in the centrist Democratic Leadership Council, she assembled the team that designed Kerry's top domestic program.



JASON FURMAN

Economic policy director, Kerry campaign

BACKGROUND Sperling aide in Clinton White House

ROLE Provides in-house economic analysis. The walking book on Kerrynomics, he keeps track of all the promises and how they add up. A bright young Harvard PhD who could land a job as a top staffer in a Kerry Administration.

(CLOCKWISE FROM TOP LEFT) PHOTOGRAPHS BY DANIEL ACKER/BLOOMBERG NEWS; DANIEL ACKER/BLOOMBERG NEWS; RICHARD ELLIS/GETTY IMAGES; LINDA SPILLERS/THE NEW YORK TIMES; FRED R. CONRAD/THE NEW YORK TIMES

COVER STORY

HEALTH CARE: NO RADICAL SURGERY

Kerry's plan aims to bridge the gaps in the current system. It won't be cheap or easy

FOR JOHN KERRY, HEALTHcare reform is what cutting taxes was for George W. Bush in 2000: More than just a signature issue, it would be the fulcrum of his Presidency and top his domestic to-do list. He would extend health coverage to 27 million of the nation's 44 million uninsured at a cost of $650 billion over 10 years.

But so far, Kerrycare has attracted little notice. One reason is that, for all its expense and complexity, the plan simply patches the current system. It would greatly expand public programs for low-income families. And rather than doing away with existing employer-based insurance—as President Clinton proposed in 1994—Kerry would bridge gaps in that system. "Kerry is saying: 'Let's maintain the status quo by pouring more money into it,'" says American Enterprise Institute health economist Joseph Antos. "It is go-with-what-you-have and try to make it better."

The Democrat hopes his formula will appeal to employers, who provide insurance for 160 million Americans. "What we've done is create powerful incentives for business to say: 'That makes so much sense that I'm buying in,'" Kerry told *BusinessWeek* on July 16. "I want to have the marketplace work. I don't want Washington mandates."

By building on the current system, Kerry is offering what Bruce Reed, president of the Democratic Leadership Council and a Kerry domestic policy adviser, calls "ambitious incrementalism." That's in sharp contrast to Bush's health plan, which might be called modestly revolutionary: He hopes to replace government and employer-based coverage with individuals buying their own insurance—but is taking just tiny steps in that direction.

Kerry's plan is built on four pillars: a $500 billion-plus expansion of two big health programs for low-income families, Medicaid and the State Children's Health Insurance Program (SCHIP); a new $250 billion federal subsidy for employers hit with hefty medical claims; a $135 billion private insurance pool that would make it easier for small businesses and some individuals to get coverage; and cost savings of as much as $300 billion from greater use of information technology and better identification and prevention of chronic diseases.

DISRUPTING THE MARKET?

THE NET COST TO the federal government, according to Emory University economist Kenneth E. Thorpe: $650 billion over a decade. Kerry argues he can pay the bill by rolling back all of President Bush's tax cut for families making more than $200,000 a year. That would generate $800 billion over 10 years and fund Kerry's health plan. But it would leave little to pay for education and other initiatives and to cut the deficit in half, as he promises.

> "I want to have the marketplace work," says Kerry

Kerry's biggest health initiative would expand Medicaid and SCHIP, which now cover poor families and children. Kids in a family of four with an annual income of less than $55,000 would be eligible for public insurance. So would singles making less than $18,000. Kerry hopes this will cover about 18 million uninsured. But critics say there's a downside: They fear employers would dump low-wage workers and their dependents on to the public program. "He's going to the heart of the employer tem," says Thorpe. "He could disrup existing market."

Some argue that a more workab less ambitious, solution might be to mote these two programs to the 10 lion children and adults who are alr eligible but haven't enrolled—largel cause they are unaware of the ben Says House Ways & Means Comm Chairman William M. Thomas (R-Ca "First, let's get everybody eligible Medicaid and SCHIP on the books."

Much of the rest of Kerry's pla aimed at shoring up the employer-b insurance system, which has sei flaws. If you change jobs, you may coverage. And while the system work large companies, it fails for smaller ou

KERRYCARE

The health plan would cost $650 billion over 10 years. The key features:

ld spend $500 billion-plus to cover 18 million working parents, their kids, and single ut of a total of 44 million uninsured. But with the government picking up the tab, could dump families into the program.

vould pay 75% of the expense for insured workers whose annual claims exceed 50,000, at an estimated cost of $250 billion. If expenses balloon, that could lead to er rationing high-cost care.

n includes $135 billion to set up a national pool of private insurance that would sell o small employers and individuals aged 55-64. Employers would get a 25% tax credit remiums, but that might not be enough. They may also balk at extra regulation.

sizing prevention and the early identification of chronic diseases, as well as better rmation technology, Kerry aims to save about $300 billion. Such promised savings—ding government waste—often prove elusive, however.

ich often can't afford the premiums. Kerry tries to remedy some of those blems. To start, he would create a nanal pool of private insurance, open to all businesses, workers between jobs, d early retirees aged 55 to 64. Insurers uld have to offer coverage to all eligible lividuals but could compete on price d benefits. Small businesses would pay least 50% of premiums. But they'd get extra 25% tax credit to defray costs.

TASTROPHIC RELIEF

E IDEA OF SUCH purchasing pools is awing interest from companies, says ry R. Grealy, president of the pro-business Healthcare Leadership Council. Yet questions whether Kerry's government-based approach will work. "Small businesses are trying to become part of larger groups," she says, "but they worry about mandates"—rules for richer coverage or specific treatments. Kerry hasn't proposed them yet, but it has happened with the federal employee plan.

Kerry would also provide another generous subsidy for employers. Today about 10% of premiums pay for annual claims exceeding roughly $50,000. Just one such event—an emergency surgery, or a case of cancer—can make insurance unaffordable for a small business.

To try to slow the rise of premiums, Kerry would have taxpayers pick up 75% of those costly claims. In return, participating companies would have to cover all workers, use money they save to lower premiums for employees, and use disease-management programs to identify and prevent costly chronic illnesses.

That new subsidy raises a big question: What will the government do in the face of huge, unlimited liabilities for pricey care? Some analysts wonder whether the feds might eventually ration big-ticket expenses. "At the least, you know the government will start asking questions" about the cost of such care, says Jeff Lemieux, executive director of Centrists.Org, a bipartisan Washington think tank.

Kerry says picking up catastrophic costs could trim premiums by about $1,000 for a family of four. Independent experts are split on how much savings consumers would see. Dearborn (Mich.) consultant Maureen Cotter says it will be closer to $100 a person. But Roland McDevitt, director of health research at consultants Watson Wyatt Worldwide, thinks Kerry is close to the mark.

Still, conservatives say the biggest flaw in Kerry's plan is that he does little to contain exploding health costs. In separate proposals, Kerry would try to hold down expenses by letting consumers buy prescription drugs from Canada and by having the government negotiate directly with manufacturers for drugs purchased through Medicare. But his broad health plan includes only modest cost savings.

ICU Critics say Kerry's plan does little to contain costs

Kerry does figure the government can save about $300 billion by expanding electronic processing of insurance claims and improving the use of disease-management programs. Thorpe figures the tech programs would reduce costs by about $7 billion a year. And while Cotter says "there is real money to be saved in the management of chronic care," achieving those savings will require upfront investment in diagnostic and education programs that companies may be unwilling to make. Done right, these changes may save $30 billion a year, as Kerry claims. But that would be just a tiny fraction of the $1.8 trillion the nation spends annually on health care.

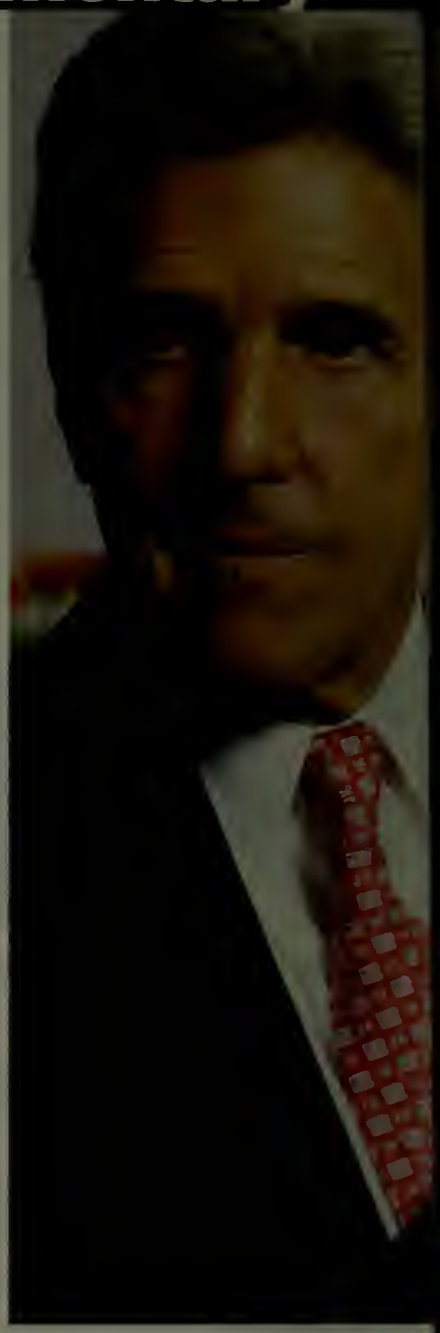
Kerry is presenting voters with a stark question: Should the government be spending hundreds of billions of dollars to patch the holes in today's fragmented health-insurance system? No doubt, his plan would insure millions of Americans now without coverage. But it also would shift some of the cost from companies and workers to taxpayers. The 2004 election will signal whether voters want to make that trade. ■

–By Howard Gleckman in Washington

COVER STORY

TALKING BUSINESS WITH JOHN KERRY

The Democratic nominee-to-be lays out why he's the better bet for U.S. companies



WARY CEOS, TAKE NOTE: John Kerry wants you to know that business has nothing to fear from his Administration. On July 16, the Democratic standard-bearer sat down with *BusinessWeek* Editor-in-Chief Stephen B. Shepard, Washington Bureau Chief Lee Walczak, and Washington Outlook Editor Richard S. Dunham for a detailed discussion of his economic philosophy.

Who would be better for business—John Kerry or George Bush?
I am going to be better for business. In Congress, I carved out an economic portfolio that has been both thoughtful and visionary—on technology and trade, on capital formation, on entrepreneurship. I decided to go to the Banking and the Commerce Committees, and now to the Finance Committee, in order to carve out a different kind of portfolio.

And what's in that portfolio?
In 1993, I did a targeted capital-gains reduction. I supported critical technologies, worked on reducing paperwork and improving [small business'] access to credit. In 1985, I was one of the first Democrats to push for the [Gramm-Rudman-Hollings] deficit-reduction effort. It was considered heresy in Massachusetts.... I am going to bring Corporate America to the table—not to lecture but to say: How do we make you more competitive? How do we get out of your way? Research-and-development tax credits? I'd make them permanent and larger. Manufacturing tax credits? That's a smart way to help.

Do you think you get credit for these things?
No.

Why not?
Because American politics has been reduced to simplistic sloganeering.

But haven't you antagonized business with attacks on "Benedict Arnold CEOs"?
Unfortunately, in primaries and the heat of politics, things get misinterpreted. I am 100% in favor of companies going abroad to do business—I'd be an idiot not to understand that. In fact, my proposal on deferral of taxes on foreign investment has been geared to recognize the distinction between legitimate business [and tax avoidance].

But a sham transaction [to relocate a corporate headquarters overseas] is a sham transaction. We have these shifts purely for the purpose of tax avoidance, and to me that's avoiding your responsibility.

Still, on the trade front, you suggested that you will reopen the World Trade Organization and NAFTA pacts to strengthen labor and environmental protections.
What I said was that I will appoint a commission. I would want my Treasury Secretary on it—and my model is somebody like Bob Rubin. I am going to do a 120-day review to look at what's working and what isn't. Is there currency manipulation? Are markets closed to us that were supposed to be open? To what degree has dumping taken place?

To amend the WTO and NAFTA, don't you have to reopen the treaties?
To do that you have to create an international process. You can't do it unilater I'm not going to just kill [treaties]. I h suggested a dialogue.

President Bush is often described as favoring a CEO management style. Describe your system.
Well, you saw the way I managed Vice-Presidential pick. [And] I put gether a multimillion-dollar campaig changed the manager in midstream, the pieces back together, and won nomination. I'm decisive. I'm a str leader. I push. I know how to set goal had four years in the military as an offi and it's a form of management.... Peo who know me know that I'm decisive, strong, and I am very demanding.

So why hasn't this registered with voter
Because America hasn't had a chance

o know me. And because nearly $90 on has been spent [by the GOP] to e me otherwise.

can you be an unknown with a ear Senate record?
me whose record in the Senate does ter. I have not spent my life trying to romote. I'm not chairman of any ma- ommittees. And if you are not, your e isn't on a bill. Still, I think I have en ground with innovative programs. the fight to put an additional 100,000 on the streets. I broke with my party ducation reform in 1995 and talked t the need for accountability—we dn't just throw resources at the sys- So I think I'm willing to think outside ox, and that will come through.

aint a pretty bleak picture of a middle-class squeeze. Are things really all that bad out there?
I'm not painting a bleak picture at all. I'm very optimistic. The pessimism is at 1600 Pennsylvania Ave., where they tell you the best we can do is lose 1.9 million jobs over four years. You guys think that's great? Come on, folks. I think we can do better.

> Research-and-development tax credits? I'd make them permanent and larger. Manufacturing tax credits? That's a smart way to help."

I'm not the one saying how tough it is out there—it's Americans who are telling me, in places like Iowa and Wisconsin and Ohio.

The deal you are offering voters seems straightforward—more affordable health care and more money for schools, financed by higher taxes on the rich.
It's going to be financed by rolling back [cuts for families earning more than $200,000]. I'm not going to tax the wealthy. There are pejoratives in the phrasing.

Are you sure repeal will get you all the money you need?
Yes, I am absolutely positive it is really there.

And what about deficit reduction?
I am absolutely committed to it.... Why is Warren Buffett supporting me? Why is Barry Diller supporting me? Why [are] Steve Jobs and Lee Iacocca supporting me? It's because they know I can restore fiscal responsibility.

Both you and President Bush propose to cut the deficit in half over four years—what's the difference?
But he doesn't! He has $6 trillion in proposals and initiatives that are not paid for. I don't. I've showed you the loopholes I would close. Show me any loophole George Bush has talked about closing. I mean, the Bush talk on this is fantasyland, folks.... He told you we weren't going to have a deficit, we could afford the tax cuts. That was the biggest B.S. I've ever heard in my life. We went straight into deficit.

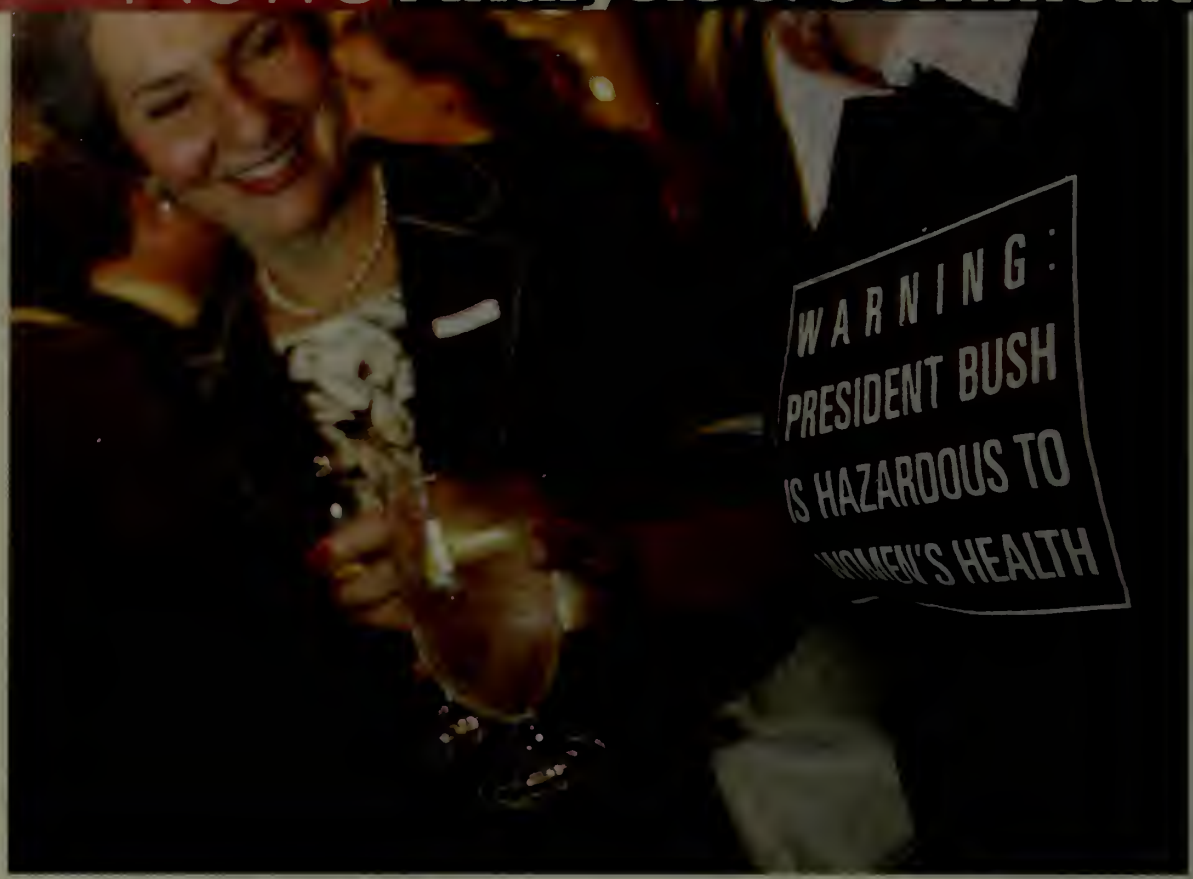
So you believe that just by rolling back tax cuts for top-end taxpayers, you can fund a health plan and deficit reduction?
Yes—absolutely. Let me be very clear: I like low marginal rates. I fought to get low marginal rates. I voted for going down to the 28% and 14% brackets [in 1986]. I am not going to raise marginal rates—ever—above the rates we had under Bill Clinton.

Under your plan, upper-income individuals also lose their tax cuts for capital gains and dividends. Won't that hurt investment?
With all due respect, look at what happened to investment in the 1990s.

We had a tech boom.
I believe we can have a tech boom again.... [But] Bob Rubin and a lot of smart people tell me the capital-gains differential [doesn't matter much]. When you're at [a capital-gains rate of] 20%, it doesn't deter you from making millions with a new idea. So you're not going to change investment patterns.

How can you expand health-care eligibility and control costs?
Let me tell you how: You're paying for very inefficient delivery of care [today].... I put together a set of principles. I want to have the marketplace work. I want people to have choice. I don't want Washington mandates. I don't want a new bureaucracy.... What we've done is create a huge incentive for business to say: "That makes so much sense that I'm buying in." In exchange for [companies] having an early health-and-wellness program [and] for [agreeing to] pass the savings along to their employees ...we're going to pick up 75% of the cost of catastrophic care. That reduces their costs and makes them more competitive.

If Congress balks at the tax changes you seek and you're short of cash for your programs, then what?
We would not be able to do as much on health care, and that is the choice in this race. George Bush wants to defend tax cuts for folks earning more than $200,000 a year. I say we can have [better] health care if we roll those back. That's your choice. And I believe if I get elected, America will have made that choice. ■



COVER STORY

THE AMAZING MONEY MACHINE

Defying doomsayers, the Dems–by some measures–are outraising the Republicans

JUST SIX MONTHS AGO, Louis B. Susman, national finance director for John Kerry's Presidential campaign, was one frustrated fundraiser. His man was sinking fast in the polls and, says the Citigroup Global Markets vice-chairman, "I was begging for contributions, but people weren't returning my phone calls." Then Kerry gambled everything on winning the Jan. 19 Iowa caucuses. He rejected federal matching funds so he could bust the state's spending cap and even mortgaged one of his houses to lend the campaign $6.4 million.

The shoot-the-moon strategy worked: Kerry won Iowa and went on to take New Hampshire and 10 other states by Feb. 10. Susman's perseverance paid off, too. On July 20, Kerry reported that his fund-raising, as of June 30, totaled $185 million, just 18% less than President George W. Bush's $226 million cache. But that hardly tells the whole amazing story of the comeback kid of campaign cash. When you add in what allied groups are spending to help oust Bush, Kerry and the Dems are remarkably competitive.

LAGGARDS NO MORE

A *BUSINESSWEEK* SCORECARD tallying receipts by the Presidential campaigns, national political parties, congressional candidates, business and labor organizations, and shadow committees known as 527s shows that the Democrats have pulled in $912 million, vs. $1.03 billion for the GOP (table). When funds raised by nine other Democratic primary candi-

CALIFORNIA SOU
Donors are driv
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however, the
Dem figure ri
$1.09 billion, e
ing the GOP's l
million. After d
of lagging, esp
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donors, "Dem
have caught up,
Michael J. M
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tute (CFI).

If anything
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the Federal El
Commission o
IRS, undercount
all campaign s
ing. The tally do
include voter turnout efforts by AF
affiliated unions, such as the $65 m
the Service Employees Interna
Union says it will spend. Nor does t
ly count programs by numerous t
empt groups, from Planned Paren
to the National Rifle Association, be
election laws do not require them t
close their spending.

The Democrats' success defies p
tions made by most campaign-finan
perts after Congress passed the Mc
Feingold reforms of 2002. The guru
that Dems couldn't possibly replac
unlimited soft-money checks that
ness, unions, and wealthy people ga
the party and that the new law ba
They predicted the party would
build a small-donor base to matc
GOP's. And they projected that Bush w
outraise his opponent by at least 2 to

The Chicken Littles of campaign
were wrong on all three counts. Dem
tic-leaning 527s—named after a secti
the tax code—have pulled in $125 mi
and the two largest, America Comin
gether and the Media Fund, say they
an additional $50 million in hard pl
By law they can't coordinate with K
but it hasn't been too difficult to do
their message with his.

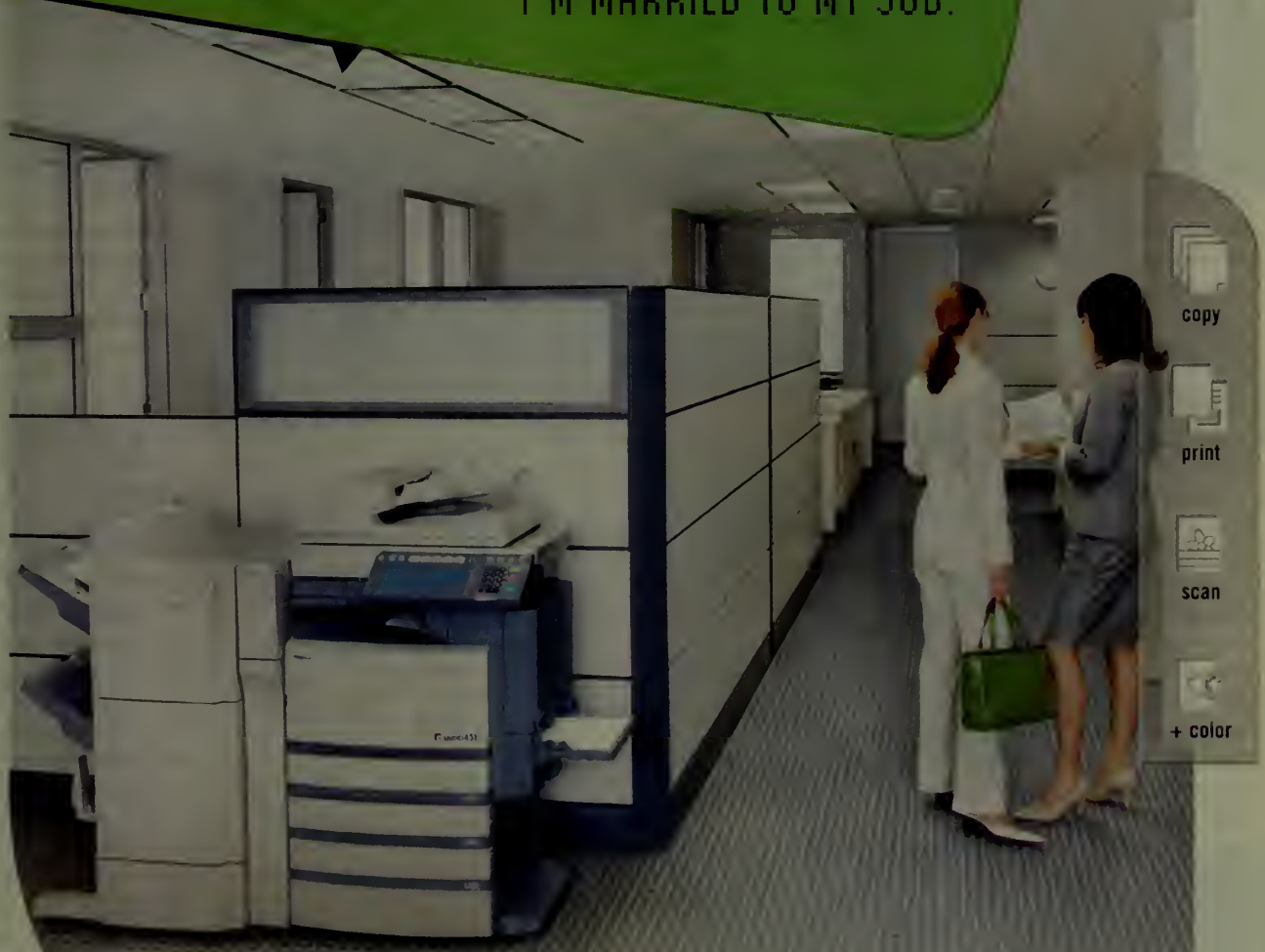
The Democrats have also leapfro
over a traditional weakness in direct-
fund-raising by using the Net to r
contributors—vastly increasing their
from small donors who give less

I make fast black and white

and affordable color.

OGLE AWAY, LADIES

I'M MARRIED TO MY JOB.



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$200. Democratic Presidential candidates raised a mere $10.5 million from small donors in 2000. This time, Democratic candidates upped that by 927%, to $107.8 million, the CFI says.

So what explains the outpouring to Dems? Many experts believe donors are driven less by a zeal to install Kerry than by a fervor to oust Bush. Dissatisfaction with the growing federal deficit, economic jitters, and Bush's rush to war in Iraq and management of the aftermath all feed the Kerry financial machine. And Kerry's ability to keep up with—and sometimes pull ahead of—Bush in the polls has inspired givers. "This sense of inevitability that Bush was going to be reelected a year ago has really disappeared," says Kerry supporter Steven Rattner, managing principal at private investment firm Quadrangle Group.

TECHIES WOOED

SILICON VALLEY HAS especially rallied to Kerry's side. Even Intel Chairman Andrew S. Grove recently contributed $2,000. Intel is a leader in the push to stop an accounting-rule change requiring companies to expense stock options—a position Kerry does not support. To woo high-tech execs, Kerry dispatched key economic adviser Roger C. Altman, chairman of New York investment firm Evercore Partners Inc., to California. On July 13, Altman camped out at Yahoo! headquarters for one-on-one meetings with Valley execs. One invitee, Marc Andreessen, chairman of software-maker Opsware Inc. and a founder of Netscape Communications Corp., had previously spoken out against Kerry's views on trade, but was won over. While he's not giving Kerry money yet, he says: "They're doing a full-court press and doing it pretty effectively."

But it's people like Andy Rappaport, a Menlo Park venture capitalist, who are key to Kerry's catch-up fund-raising. Rappaport and wife, Deborah, have "maxed out" by giving a combined $190,000 to Kerry, party committees, and other Democratic candidates. Overall, the couple has donated $5 million to liberal causes, including 527 groups that now accept the soft money that the party can't. Rappaport reports that he gets daily calls from people who say: "I've been a Republican my whole life, and I never thought I'd vote for a Democrat. But I am so angry at what this Administration is doing that I'm not only going to vote for John Kerry, but I want to have a fund-raiser for him."

But nothing has succeeded for Kerry like the Internet. Kerry has raised $57 million through online donations, or nearly one-third of his total. Bush, by comparison, has raised a mere $9 million online. The beauty of these contributions, says Kerry Internet fund-raising director Josh Ross, who took a leave from his job as a vice-president at Silicon Valley pany USWeb, is that the donatio "low-effort and high-margin." The c raising $1 via the Net is about 3¢, v for a telemarketing call or a piece of mail. And five-course dinners that a high-rollers who can give up to $ apiece can eat up 25¢ of every $1 ra

Still, Bush has a couple of advan He has $64 million in cash on against Kerry's $36 million. And alth both candidates are expected to accep million in public funding for the ge election, Bush has the upper hand th well. Public money kicks in as as candidates accept the nor tion. After that, they can't rai spend private funds. Kerry's lem is that the clock starts o 29—five weeks before the convention. So Kerry has five er weeks in which to raise pr money and must stretch his million over 13 weeks, vs. Bus weeks, until Election Day on N

One way Kerry is expecte conserve his treasury is by "g dark" for much of August. the Democratic Convention may forgo TV ads while trave through 10 battleground st banking on free media. He distribute surplus money to Democratic National Comm and state parties, which can TV ads—as long as they don' ordinate with his campaign.

The 527s will also be abl run TV ads in August. But Sept. 2, most will have to turn the spigot. McCain-Feingold l them from paying for ads identify a specific candidate days before the election—e though they can keep spen on voter turnout. In the end, ry may not have to dip into public funds until Sept. 3, w Bush begins doing the same.

These days, Kerry fina chairman Susman is a lot frustrated. Since March, "I ne asked anybody for money and turned down. Not once," he s In fact, money is walking in off street. A woman recently stro into Kerry's Washington he quarters and handed Susman Ann Taylor shopping bag. I was $40,000 in checks. ■

–By Paula Dwyer in Washi ton, with Robert D. Hof and Kerstetter in Silicon Valley Marcia Vickers in New Y

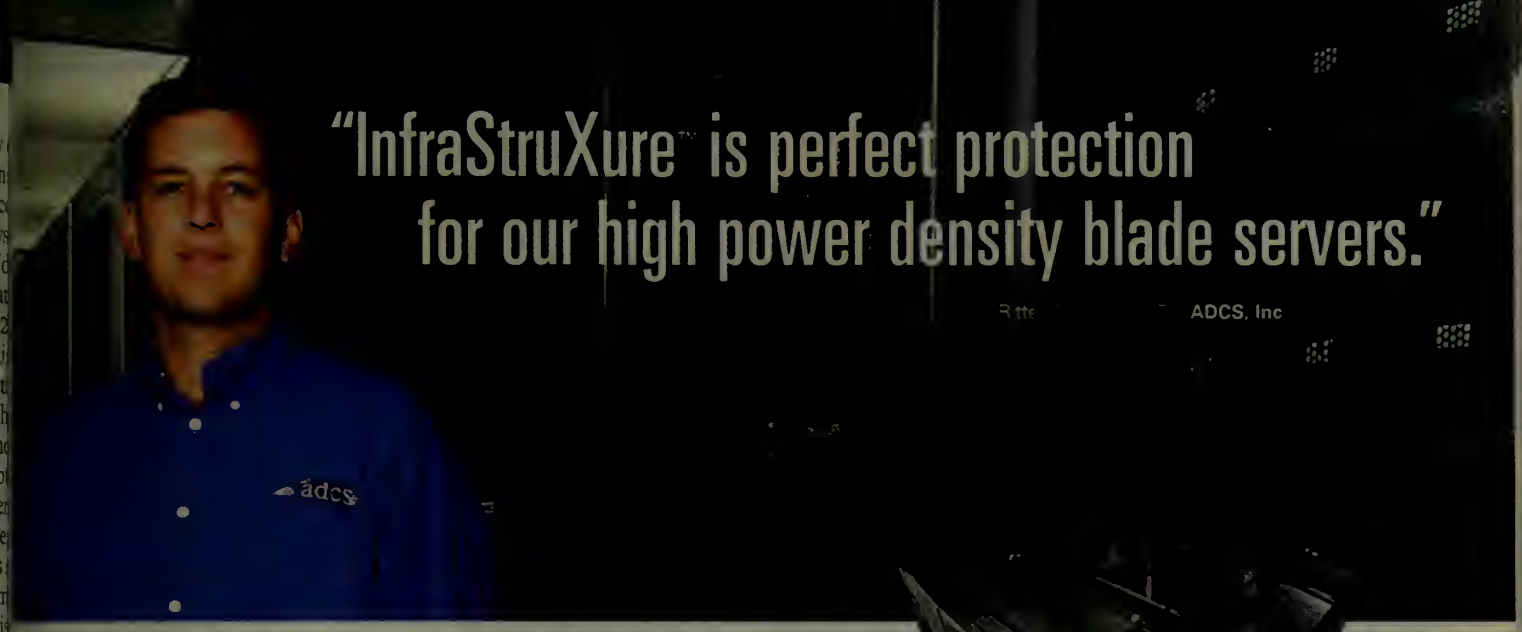
THE DEMOCRATS' DOLLAR SURPRISE

They could edge out the GOP in the money race

	DEMOCRATS	REPUBLICANS
	MILLIONS OF DOLLARS RAISED	
KERRY/BUSH CAMPAIGNS [1]	$185	$226
NATIONAL POLITICAL PARTIES [2]	125	217
527 COMMITTEES [3]	125	23
ORGANIZED LABOR [4]	44	0
BUSINESS GROUPS [5]	0	8
HOUSE CANDIDATES [6]	144	210
SENATE CANDIDATES [6]	145	120
CONGRESSIONAL CAMPAIGN COMMITTEES [7]	104	163
CONVENTIONS [8]	40	64
DEMOCRATIC PRIMARY CANDIDATES [9]	176	0
TOTAL W/DEMOCRATIC PRIMARY CANDIDATES	$1,088	$1,031
TOTAL W/O DEMOCRATIC PRIMARY CANDIDATES	$912	$1,031

1. All figures rounded to nearest million, as of June 30 unless otherwise noted. Includes $6.4 million Democrat John Kerry lent his campaign. 2. Democratic National Committee and Republican National Committee. 3. Spending by the 50 most active 527s that are predominantly liberal or conservative in ideology. 4. As budgeted by AFL-CIO; only other labor spending appears under 527s. 5. Independent spending by Business-Industry Political Action Committee, National Federation of Independent Business. 6. As of May 31. 7. Includes House and Senate campaign committees for both parties. 8. Fund-raising goals of convention committees. 9. Funds raised by Kerry's nine primary opponents.

Data: Federal Election Committee, PoliticalMoneyLine, Center for Responsive Politics, Business-Industry Political Action Committee, National Federation of Independent Business, AFL-CIO, Democratic National Committee, and Republican National Committee



ith its modular, scalable and open building blocks, s no wonder InfraStruXure's rack-based architecture is nning over editors and end-users alike – especially as de servers and server consolidation cause power nsities to skyrocket.

you're not already dealing with such high power nsities, the chances are you will be soon. An on-demand chitecture for NCPI*, InfraStruXure™ includes power, oling, racks and physical structure, security and fire otection, cabling, and the management and servicing these elements. It is specifically designed to meet er-changing IT requirements through scalable, modular d standardized components.

r high density applications, the InfraStruXure High Density onfiguration is a patent-pending hot aisle containment stem that cools up to 20kW in a single enclosure.

exible enough to be moved or changed without stem reconfiguration, the InfraStruXure High Density onfiguration can also be scaled to meet changing needs d future expansion. This makes it a perfect solution converted spaces, as well as high-density areas.

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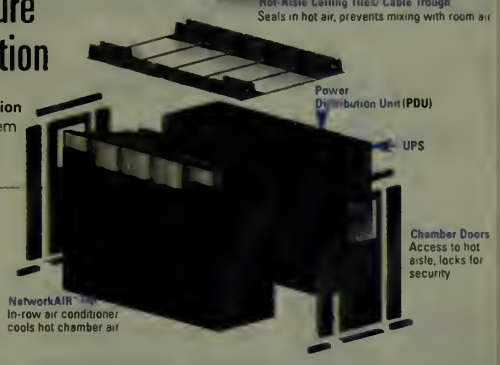

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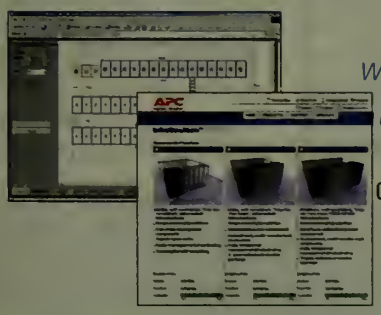

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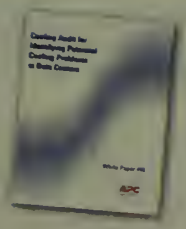

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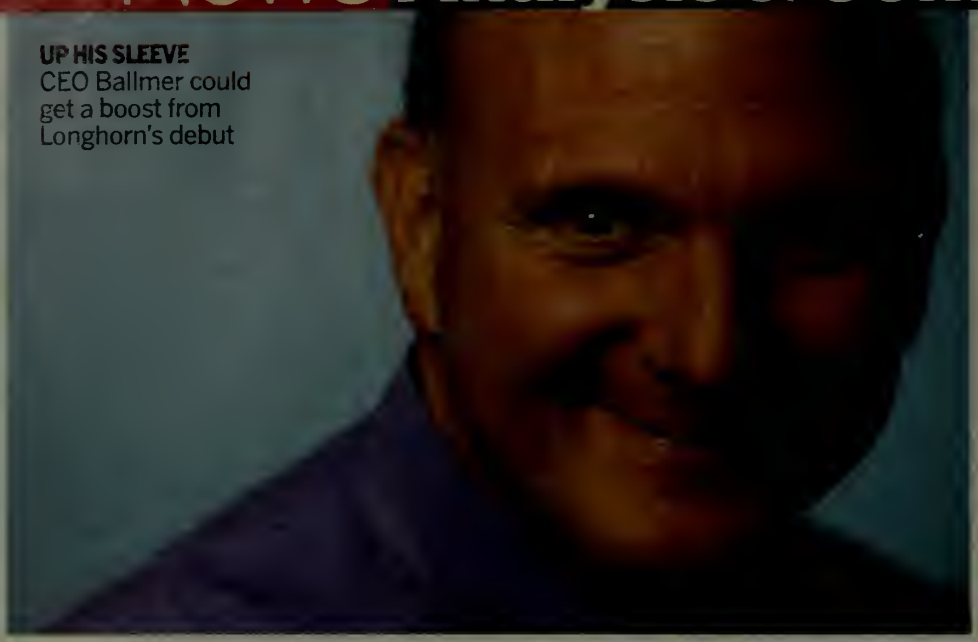


UP HIS SLEEVE CEO Ballmer could get a boost from Longhorn's debut

SOFTWARE

WHEN THE GROWING GETS TOUGH...

Even after its huge dividend, Microsoft has plenty in the till to grow businesses

MICROSOFT'S ANnouncement on July 20 that it will distribute a large chunk of its cash hoard to shareholders makes it look like the software giant has finally accepted that it's a mature company. After all, it will spend an astonishing $75 billion over the next four years on dividends and stock buybacks—instead of investing that money in new growth opportunities. Investors will be able to count on Microsoft Corp. as a steady profit earner and source of dividend income—much like a regulated monopoly.

But just because Microsoft is handing a load of cash to stockholders doesn't mean it won't have plenty of dough to invest in its future. After it makes a onetime special dividend payment of $32 billion in December, it will still have more than $20 billion in cash. And thanks to its profitable Windows and Office monopolies, it's racking up $1 billion in cash every month. That's enough to buy a lot of growth—whether through acquisitions, product upgrades, or new business expansion. "When we look out over the next several years, I'm confident we have some of the greatest dollar-growth prospects in front of us of any company in the world," says Microsoft CEO Steven Ballmer.

Most stock analysts expect the $36 billion company to grow in the singl for the next few years. But if the sta it could produce a surge toward th the decade. Here's how the scenari work: The company is betting big next major update of Windows. Longhorn, which is expected out i Since there hasn't been a major u since 2001, you can expect to see demand from both corporations a sumers. Right after that, Microsoft second wave of product upgrades, ing new versions of its Office prod suite and its applications for sm medium-size businesses. If thing right, it could also be reaping from investments in the Xbox vide console and MSN Web site at th time. Analyst Rick Sherlund of Go Sachs & Co. says growth could re high as 15% in fiscal 2007 or 2008.

"IT'S TIME WE BOUGHT SAP"

WHAT COULD GO WRONG? Micro facing the most serious threat to it ating system monopoly that it has years. Its chief adversary is not a software company but Linux, the source operating system. Govern around the world, leery of becomi dependent on Microsoft, are encou their agencies and local companie vor Linux over Windows. That's c Microsoft trouble in one of the ind biggest growth areas—emerging m such as China, India, and Russia.

That's why its biggest growth op nity is in doing something complete ferent and out of character: Making jor acquisition. Though Microso long been an active acquirer, it ha centrated on smallish purchases th important new technologies. Cha William H. Gates III signaled a w ness to break out of that mold with 2003 e-mail he sent to Ballmer sponse to news that software rival Corp. had made a bid to buy corpora plication maker PeopleSoft Inc. G suggestion: "Another thought that to mind is that it's time we bought the runaway leader in the $30 billio porate applications market.

Can $20 Billion Buy Microsoft Growth?

While many expect it to grow less than 10% per year, newer businesses—and acquisitions—could boost that rate

ACQUISITIONS

While Microsoft traditionally has bought small companies rather than big ones, it might make a major acquisition or two in key markets. Possible targets: Accenture in tech services and Siebel Systems in customer-management software.

PRODUCT IMPROVI

By the time Microsoft deliver its next Windows update, in 2 have been five years since th refresh, so analysts expect a generation of related produc will follow, including a new M Office and server software.

While those talks foundered this ing, analysts believe Microsoft is still king at possible deals that would im- ve its position in selling to corporate tomers. One possible acquisition is bel Systems Inc., a specialist in cus- ner-management software. Even SAP ains a possibility. Though the deal is cially off the table, some analysts be- e talks could resume if Oracle eventu- buys PeopleSoft, putting pressure on rosoft's server business.

The most intriguing and dramatic l would be for services giant Accen- e. The company, which has a market of $24 billion, is a powerhouse in lucrative consulting and business sourcing arenas. Already there are nities between the two companies: lmer sits on Accenture's board and two companies co-own Avenade, a tique consulting outfit that special- in Microsoft technology.

f Microsoft doesn't make a major chase, some of its best growth bets ne from businesses launched in the 0s. A decade ago, Microsoft moved the server software business, the rket that has produced its most aningful sales gains in recent quar- s. The server business is kicking off re than $8 billion a year, and analysts ect it to keep growing at a strong ble-digit rate.

Now, Microsoft is hoping it can dupli- e that success in the fast-growing rket for software for small and medi- -size businesses, which is close to rosoft's core competencies. The npany bought its way into the market years ago by acquiring two existing yers, Great Plains Software and Nav- n, for a combined $2.5 billion. But so that hasn't worked out as planned— h growth coming in at only 4% in the npany's fourth fiscal quarter.

Are Ballmer's goals realistic? Maybe . But it's fine to have them. If need a company to grow at 10% year, it's not a bad idea to aim high- —especially if you're running a turing company. ■

–By Jay Greene in Seattle

ER BUSINESSES

t is pushing hard into online services rch with MSN, into entertainment with x game console, and into software for d medium-size businesses. If these he same time as Longhorn, the next of its operating system, revenues could gain.

THE PAYOUT

Any Dividend From The Microsoft Dividend?

"Dude, where's my cash?" That's the question investors have been asking Microsoft Corp. for months as the company's green stuff piled up to some $60 billion. On July 21 they got their answer. Microsoft announced the largest one-time corporate dividend in history. On Dec. 2, it will pay out an eye-popping $32 billion to shareholders. It will also double its annual dividend to 32¢ a share, or $3.5 billion, and buy back $30 billion worth of its own stock over the next four years.

Will the payout have any impact on the economy? After all, individuals own about 30% of Microsoft's stock, and they will get some $9 billion in the payout. That's almost in the same league as the $14 billion U.S. families received last year with the expanded child-credit tax cut. Folks are also wondering whether the cash will boost the stock market. Not a dumb question: Index funds, big holders of the stock, will have to reinvest the cash in short order.

Truth is, the big pay day won't affect the economy or overall market too much. That's because both institutional investors and individuals will likely deploy the windfall in different ways. Indexer Patrick O'Connor, senior portfolio manager at Barclays Global Investors, the second-largest institutional holder of Microsoft shares, says he'll swing into action after Nov. 17—the deadline for investors who want to buy the stock and reap the dividend. He'll be buying Standard & Poor's 500-stock index futures contracts in order to track the index as closely as possible as Microsoft likely swoons. After the Dec. 2 payout, he'll buy shares outright for the exchange-traded funds he manages. "I think indexing-buying could affect the performance of the smaller S&P 500 stocks. But it's not going to move General Electric," he says.

Steven Neimeth, senior portfolio manager at AIG SunAmerica Asset Management, who runs several actively managed funds, thinks Microsoft's actions may boost the stocks of cash-rich companies such as Limited Brands Inc. and Hewlett-Packard Co. "I think we're going to see more dividend and buyback announcements from companies in the coming months," he says.

And when it comes to the overall economy, experts say that most investors will also likely use the extra cash to buy more shares. "It's unusual for people to ask for a cash check when they receive a dividend," says Barclay's O'Connor. And even if they do, there's no guarantee they'll spend the money on, say, an Armani suit. Indeed, most investors will probably reinvest it or keep it in a cash account at their brokerage. One thing for sure, Microsoft Chairman Bill Gates isn't going to be plowing his money directly into the economy: He has pledged his personal $3.4 billion windfall to his charitable foundation.

Quite A Haul

Who gains the most from Microsoft's $3 special dividend:

	NUMBER OF SHARES (MILLIONS)	VALUE OF DIVIDEND (MILLIONS)
Bill Gates	1,118	3,354
Fidelity	432	1,296
Steve Ballmer	411	1,233
Barclay's Global	378	1,133
State Street	296	888
Vanguard Group	225	676
AXA	179	538
Capital Research Mgmt.	172	515
Wellington Mgmt	146	439
Northern Trust Corp	141	422

Data: Bloomberg Financial Services

Longer run, the main gainer might be Microsoft stock. Says shareholder Richard Steinberg, the head of Steinberg Global Asset Management in Boca Raton, Fla.: "Microsoft could have used the money for some potentially disastrous deals. This eliminates the notion of them doing something stupid with that money."

–By Marcia Vickers in New York

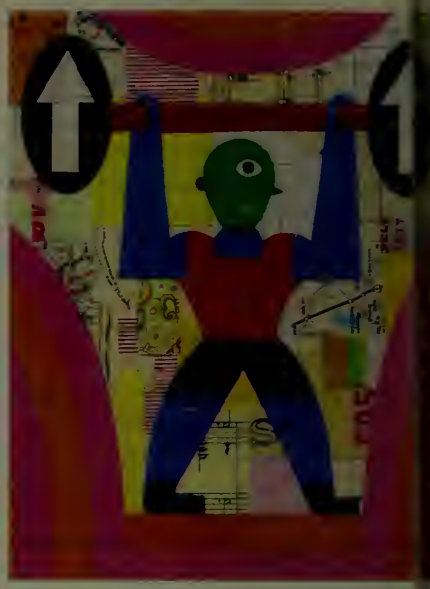
EARNINGS

AN ADDED LIFT

Stronger demand is driving profit gains

CORPORATE EARNINGS continue to surprise. *BusinessWeek*'s flash profit survey of 78 early-filing companies shows second-quarter income from continuing operations before extraordinary items rose 46% vs. a year earlier. The gain, however, was skewed by drugmaker Pfizer Inc., which swung to a $2.8 billion profit from a $3.7 billion year-ago loss, brought on by a special charge. Remove Pfizer, and flash profits rose by 23%. Not bad, given that analysts surveyed by Thomson First Call had predicted at the start of the quarter that profits from continuing operations in the Standard & Poor's 500-stock index—which excludes special items in addition to extraordinary items—would climb by just 14.9%.

The continued acceleration in sales growth gave profits the added lift. Revenues of early filers rose 12%, the third double-digit increase in a row. Economists say better demand and pricing power are driving the gains. Combine that



Go-Go Second Quarter

	CURRENT QTR. SALES (MILLIONS)	% CHG.	QTR. PROFITS (MILLIONS)	% CHG.	THOMSON FIRST CALL DATA ANALYSTS' EST. EPS	REPORTED EPS	DIFF.
INDUSTRIALS	**274,342.4**	**+10**	**24,696.7**	**+78**	**0.61**	**0.62**	**+0.01**
Abbott Laboratories	4,703.0	+14	634.9	+254	0.54	0.54	—
AK Steel Holding	1,311.8	+34	20.2	NM	0.16	0.18	+0.02
Alcoa	6,092.0	+11	404.0	+86	0.47	0.46	−0.01
Altria Group	16,445.0	+6	2,627.0	+8	1.28	1.25	−0.03
American Standard	2,575.3	+14	159.7	+19	0.72	0.73	+0.01
Colgate-Palmolive	2,571.7	+5	373.9	+4	0.66	0.66	—
ConAgra Foods †††	3,962.4	+9	199.0	−8	0.42	0.41	−0.01
Crown Holdings	1,836.0	+6	33.0	−34	0.28	0.29	+0.01
Delphi	7,549.0	+6	131.0	+49	0.28	0.28	—
Eastman Kodak	3,469.0	+6	143.0	+35	0.59	NA	NA
Eaton	2,403.0	+19	161.0	+73	1.02	1.06	+0.04
Ford Motor	42,802.0	+5	1,162.0	+173	0.50	0.61	+0.11
General Dynamics	4,761.0	+21	296.0	+22	1.40	1.47	+0.07
General Electric	36,711.0	+10	3,924.0	+3	0.37	0.38	+0.01
General Motors	49,148.0	+7	1,341.0	+53	2.24	2.36	+0.12
Harley-Davidson	1,408.9	+9	247.2	+22	0.75	0.83	+0.08
Honeywell International	6,388.0	+11	361.0	+13	0.38	0.42	+0.04
Johnson & Johnson	11,484.0	+11	2,458.0	+103	0.79	0.82	+0.03
Johnson Controls ††	6,792.3	+14	222.3	+17	1.15	1.15	—
Kraft Foods	8,205.0	+5	698.0	−26	0.46	0.46	—
Merck	6,021.7	+9	1,768.1	−1	0.79	0.79	—
Nike †††	3,487.1	+17	305.0	+24	1.08	1.13	+0.05
Occidental Petroleum	2,750.0	+21	581.0	+55	1.43	1.46	+0.03
PepsiCo	7,070.0	+8	1,059.0	+12	0.61	0.61	—
Pfizer	12,274.0	+24	2,844.0	NM	0.47	0.47	—
3M	5,012.0	+9	773.0	+25	0.96	0.97	+0.01
United Technologies	9,622.0	+24	837.0	+32	1.58	1.66	+0.08
Whirlpool	3,264.0	+9	106.0	+13	1.49	1.53	+0.04
Wyeth	4,223.2	+13	827.3	−4	0.59	0.62	+0.03
SERVICES	**145,873.0**	**+13**	**14,464.3**	**-20**	**0.87**	**0.91**	**+0.04**
Allstate	8,304.0	+5	1,034.0	+76	1.15	1.47	+0.32
AMR	4,830.0	+12	6.0	NM	−0.10	NA	NA
Bank of America	NA	NA	3,849.0	+41	1.74	1.86	+0.12
Best Buy †	5,475.0	+17	114.0	+65	0.33	0.34	+0.01
Circuit City Stores †	2,072.2	+7	−5.2	NM	−0.07	−0.03	+0.04
Citigroup	27,287.0	+14	1,144.0	−73	0.97	1.02	+0.05
Costco Wholesale ††	10,897.2	+14	198.7	+29	0.38	0.42	+0.04
Delta Air Lines	3,961.0	+13	−1,963.0	NM	−2.46	−2.55	−0.09
Dow Jones	437.8	+11	34.0	+10	0.38	0.41	+0.03
FedEx †††	7,041.0	+21	412.0	+47	1.33	1.33	—
Gannett	1,873.3	+10	354.4	+9	1.30	1.30	—

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Genuine Parts	
Goldman Sachs Group	
JPMorgan Chase	
Lehman Brothers Holdings	
Manpower	
Marriott International	
Merrill Lynch	
Morgan Stanley	
New York Times	
Schwab (Charles)	
Southwest Airlines	
U.S. Bancorp	
UnitedHealth Group	
Wachovia	
Walgreen ††	
Wells Fargo	
YUM! Brands	
TECHNOLOGY	6
Advanced Micro Devices	
Apple Computer ††	
First Data	
Genentech	
Intel	
International Business Machines	
Lexmark International	
Lucent Technologies ††	
Motorola	
Oracle †††	
Sanmina-SCI ††	
Solectron ††	
Sun Microsystems †††	
Texas Instruments	
Yahoo!	
UTILITIES & TELECOM	18
AT&T Wireless Services	
Hawaiian Electric Industries	
Nextel Communications	
Florida Progress	
Sprint	
Telephone & Data Systems	

† First-quarter results †† Third-quarter results ††† Fo
NM = not meaningful NA = not available

a continued zeal for holding down s, says Richard D. Rippe, chief econ- st at Prudential Equity Group LLC, l you have a great mix for profits." eading the pack was the tech sector. ng the standouts: Apple Computer , whose profits surged 221%. Finan- firms did well, too. While one-time ges for legal settlements hit profits Citigroup, they soared elsewhere. gan Stanley led the way with a % gain. And thanks mostly to their ce arms, U.S. carmakers scored, as . Ford Motor Co.'s profits rose 173%. ising rates could slow things some- t in the third quarter, although nomists still forecast robust profits. t businesses can live with that. ■

–By Robert Berner in Chicago

. PROFITS ILLIONS)	% CHG.	THOMSON FIRST CALL DATA ANALYSTS' EST. EPS	REPORTED EPS	DIFF.
101.1	+12	0.57	0.58	+0.01
187.0	+71	1.95	2.31	+0.36
548.0	NM	0.83	0.85	+0.02
609.0	+39	1.91	2.01	+0.10
53.1	+82	0.52	0.56	+0.04
160.0	+27	0.61	0.67	+0.06
078.0	+10	1.09	1.06	-0.03
223.0	+104	1.06	1.10	+0.04
75.7	+4	0.50	0.50	—
113.0	-10	0.09	0.08	-0.01
113.0	-54	0.16	0.15	-0.01
036.9	+13	0.53	0.54	+0.01
596.0	+36	0.92	0.93	+0.01
252.0	+21	0.96	0.98	+0.02
344.6	+16	0.32	0.33	+0.01
714.0	+12	1.04	1.00	-0.04
178.0	+46	0.52	0.55	+0.03
077.9	NM	0.20	0.21	+0.01
32.2	NM	0.09	0.09	—
61.0	+221	0.15	0.17	+0.02
463.9	+33	0.53	0.53	—
170.8	+29	0.19	0.19	—
757.0	+96	0.27	0.27	—
990.0	+15	1.12	1.16	+0.04
136.6	+34	0.97	1.02	+0.05
387.0	NM	0.02	0.04	+0.02
203.0	NM	0.18	0.21	+0.03
988.0	+15	0.18	0.19	+0.01
11.4	NM	0.06	0.07	+0.01
-65.4	NM	0.00	0.01	+0.01
795.0	NM	-0.04	-0.05	-0.01
441.0	+264	0.25	0.25	—
112.5	+121	0.08	0.08	—
802.1	+154	0.18	0.21	+0.03
61.0	-73	-0.01	0.02	+0.03
11.7	-55	0.38	0.44	+0.06
302.0	+321	0.51	0.55	+0.04
153.0	-1	0.72	0.79	+0.07
233.0	NM	0.18	0.20	+0.02
41.4	NM	0.60	NA	NA

Data: Standard & Poor's Compustat
Earnings estimate data provided by Thomson First Call

GAMBLING

LITTLE GUYS WITH BIG PLANS FOR VEGAS

Casino consolidation is rampant, but independent owners are hitting the jackpot, too

WHEN INTERNET travel site founders Timothy Poster and Thomas Breitling acquired the Golden Nugget Hotel & Casino in downtown Las Vegas from giant MGM Mirage in January, they quickly put their own mark on the joint. They raised betting limits, built a new room for poker players, booked top-shelf headliners such as Tony Bennett, and nabbed a starring role in *The Casino*, a reality TV show on Fox. Poster says the casino's sales and profits have jumped by double-digit percentages so far this year. "Before, the casino wasn't allowed to compete with its sister properties," he says. "Those constraints are gone."

The Golden Nugget's new owners are rolling the dice in the face of the largest consolidation in the casino industry's history. On July 15, Harrah's Entertainment Inc. announced that it's buying rival Caesars Entertainment Inc. for $9.4 billion. The deal comes just a month after MGM Mirage agreed to purchase Mandalay Resort Group for $7.9 billion. Together the two companies could end up controlling over 70% of the hotel rooms and casino space on the Las Vegas Strip. Both deals are expected to come under close scrutiny by state regulators and the Federal Trade Commission.

So is it time for the city's remaining independents to fold their cards? Hardly. A bevy of well-heeled and creative Las Vegas casino bosses figure they can keep the odds in their favor with a bunch of new billion-dollar resorts. The flashiest is the Wynn Las Vegas, impresario Stephen A. Wynn's $2.5 billion palace, with a Ferrari dealership, golf course, and an eight-story mountain. The upscale resort, which opens next spring, is sure to draw crowds, as has just about everything the Vegas legend has ever put up. Says gaming expert and University of Nevada at Las Vegas professor William N. Thompson: "Consolidation doesn't hurt him. It helps him. It brings more attention to Vegas."

Also at the table: Sheldon G. Adelson, founder of the Comdex trade show and owner of Venetian Resort Hotel Casino. Adelson, who recently opened a casino on the island of Macau and is considering a public offering for his Las Vegas Sands Inc., hopes to build a $1.5 billion casino hotel, the Palazzo, on land between the Venetian and Wynn's new resort.

The big guys, though, have plenty of muscle. Harrah's CEO Gary W. Loveman, an ex-Harvard University business prof, says his latest deal will lure gamblers from other Harrah's properties, using a database of 27 million customers.

But bigger doesn't always mean better. The hottest joint in town is Palms Casino Hotel Las Vegas. Opened three years ago by New Mexico's Maloof family, the 455-room property cost just $260 million to build and is producing a 23% return on capital, says co-owner George Maloof. It distinguishes itself through clever events such as a weekly poolside party called Skinny Dip Tuesday Nights. "There will always be a market for a person who doesn't feel comfortable in a big casino setting," Maloof says. Mega-casinos, watch out. The little guys just might play you for a sucker. ■

–By Christopher Palmeri in Los Angeles

ILLUSTRATION BY NOAH WOODS; PHOTOGRAPH BY MARTIN LE PIRE

EDITED BY MONICA ROMAN

HEADLINER

JEFFREY KATZENBERG

REVENGE OF THE TOONS

Walt Disney CEO Michael Eisner may have thought he had troubles with Steve Jobs's Pixar Animation Studios, which wants out of its deal with Disney. Now, just as Disney's animation unit is trying to stage a comeback, former Disney studio chief Jeffrey Katzenberg is arming his DreamWorks SKG to pump out more animated films. Katzenberg, who launched DreamWorks in 1994 with fellow moguls David Geffen and Steven Spielberg, will be CEO of a publicly traded DreamWorks animation unit that plans a $650 million initial public offering. The unit, which will be separate from DreamWorks' live-action division, will release two computer-generated animation films annually, the most in Hollywood. DreamWorks' current release *Shrek 2* is the highest-grossing animated film ever, with sales of more than $410 million. Next up: *Shark Tale*, with the voices of Will Smith and Robert DeNiro, in October. Long gone are the days when no one could rival Disney's animated films.

–Ronald Grover

DON'T FLINCH, FILL 'ER UP

With turmoil in the Middle East and intrigue in Russia, you would think gas prices would be shooting through the roof. Not so. Even though oil has recently flirted with near-record highs—closing at $40.58 a barrel in New York futures trading on July 21—gasoline at the pump has just inched upward. The **Energy Dept.** says the national average price for regular was just under $1.93 on July 19. That's well below the $2.06 average just before Memorial Day. The reason? Fears that the U.S. would run short of gasoline during the summer driving season are receding. On July 21, the Energy Dept. announced that U.S. gasoline inventories rose by 2.5 million barrels in the week ended July 17, even though they usually fall at this time of year. With Labor Day in sight, futures traders are starting to dump gasoline.

READY TO ROCK AT MTV

Judy McGrath became one of

the highest-ranking women execs in media on July 20, when she was promoted to chairman and CEO of **Viacom's MTV Networks** from group president. McGrath, 51, succeeds Tom Freston, who was earlier named co-president and co-chief operating officer at Viacom. In her new job, the Scranton (Pa.) native will oversee not only MTV but Comedy Central, Nickelodeon, Spike TV, and other channels. Her promotion prompted the resignation of MTV COO Mark Rosenthal. Known for developing cutting-edge programming, McGrath must keep audiences glued to MTV Networks at a time when they have more entertainment choices than ever.

A MATCH FOR MOLSON?

The global club of beer brewers keeps getting cozier. To keep up with **Anheuser-Busch** and **SABMiller,** which have grown through acquisitions, **Adolph Coors** and Canada's **Molson** confirmed on July 19 that they were in "advanced negotiations" to merge. The combined company would have $6 billion in annual sales, closing in on SABMiller, the world's No. 2 brewer with $8 billion in revenue. Anheuser is No. 1 with $14 billion. But analysts are questioning whether the deal would be much of a boost for Coors or Molson. The two already market each other's brands, so they're unlikely to see any market-share gains in the U.S. or Canada.

LOVE THAT LINCOLN

It has been a topsy-turvy year in **J.D. Power** Associates auto surveys. In April, upstart **Hyundai** bested **Toyota** in initial vehicle quality. Then on July 20, **Ford Motor's** Lincoln nabbed top honors in Power's annual survey of customer satisfaction with dealer service, followed by **General Motors'** Buick. The two left perennial leaders Infiniti and Lexus in th dust. Lincoln, whose h quality has cut repair w nabbed a record satisfa score—912 out of a pos 1,000 points—to top P list for the first time in years. Now, Lincoln an Buick dealers need to w back buyers who have defected to imports.

ET CETERA..

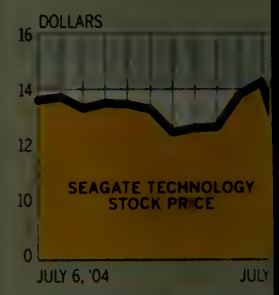
» Former **NYSE** Chairm Richard Grasso sued th Board for breach of cont seeking $50 million.

» Fiber-optic equipme maker **Corning** returned profitability.

» Eight states sued five U.S. power companies, demanding emission cu

CLOSING BELL

Will there ever be joy in Disk-Drive Land? After post a $33 million second-quarter loss, Seagate Technology share skidded 16.4%, to $11.96, on July 21 Its plans to regist 60 million new shares also has investors worried about dilution.



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Chris Burke, CTO, Vodafone UK

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EUROPE

PRODUCTIVITY PARALYSIS

If Europe doesn't boost spending on tech, it will fall further behind

WHY CAN'T EUROPE be more productive? That's a question investors, executives, and politicians are asking with increasing urgency. Boosting labor productivity is the key to creating higher profits, improving living standards, and keeping prices stable. For decades after World War II, Europe kept pace or even surpassed the U.S. in productivity growth. But since 1995, Europe has trailed America in this vital metric.

The gap is even widening. This year the U.S. should record productivity gains of 3.3%, according to Eurostat, the statistical agency of the European Union. That's almost twice the rate of France and Germany and well above the British rate (yes, even dynamic Britain is struggling in this area). Europe now has an hourly output per worker some 20% below American levels.

The productivity numbers have become so alarming that European Central Bank boss Jean-Claude Trichet warned about the problem in a July 1 speech. The Dutch, who have seen their once-robust economy stumble, are getting worried. "Future economic growth will require a substantial increase in our productivity," says Economic Affairs Minister Laurens Jan Brinkhorst. Patricia Hewitt, the British Secretary of State for Trade & Industry, has made improving productivity a top priority: It's the only way Britain can close a still-considerable gap in living standards between British workers and their U.S. counterparts.

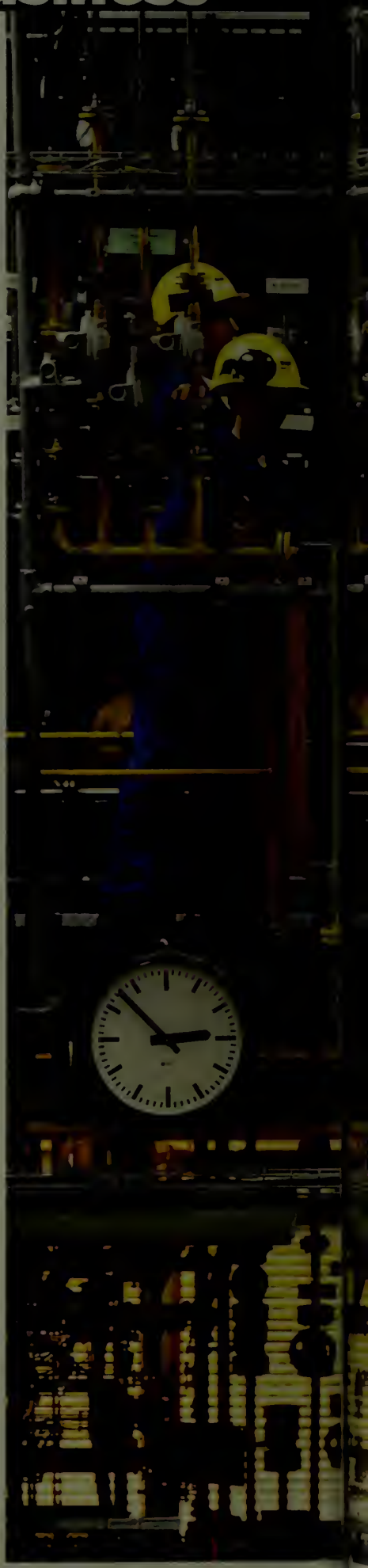
But what exactly is wrong? The short answer is that Europe is not seeing the same productivity bang from information technology that the U.S. has enjoyed over the past decade. The long answer is that uniquely European factors—from stiff job-protection codes to hidden barriers against competition—amplify the problem. There is no simple fix.

Start with the issue of info-tech spending. A key to productivity increases is using IT to get the most out of workers and plants—whether it's customer-relationship software in a sales office, process-control technology in a factory, or inventory-tracking systems in a store. European companies have ample access to all this knowhow from U. S. and Asian tech providers, not to mention from other European firms such as software giant SAP, industrial powerhouse Siemens, or mobile-phone maker Nokia.

A DIFFERENT MIND-SET

BUT THIS IS WHERE the differences between Europe and the U.S. become stark. European executives have invested much less in IT than have their U.S. counterparts. According to the Organization for Economic Cooperation & Development, in France, spending on information and telecommunications technology accounted for 1.97% of gross domestic product in 2002. U.S. IT spending accounted for 4.42% (chart). That partly reflects differences in mind-set, says Roger Fulton, an analyst in the British office of IT researcher Gartner Inc. "The U.S. is a 'just do it' society, whereas Europe has more of a 'let's think about it' society." That results in a greater hesitancy to buy into the benefits of IT and, therefore, to lower IT spending.

There's also a chicken-and-egg prob-



GERMANY'S BASF
Trimming R&D

lem with IT investment in Europe. Heavy spending can help a company produce more with fewer workers—often making layoffs inevitable, even desirable. "But the labor market is less flexible in Europe than in the U.S.," says Kasper Rorsted, managing director for Hewlett-Packard Co. in Europe, the Middle East, and Africa. "Employees in Europe are seen as more of a fixed cost—not something you can easily trim." With the cost of laying off a worker so high in Europe, companies hesitate to spend on labor-saving information technology in the first place. Rorsted is so concerned about low IT spending in Europe that he confers monthly with policymakers in Brussels on crafting investment incentives and loosening regulation.

In Europe, cutting IT spending is easier than laying off workers

Europe also simply doesn't have as large a tech sector as the U.S. That matters because fast-growing technology companies are themselves major contributors to productivity growth. According to McKinsey & Co., the IT sector generates 2.3% of total GDP in the U.S., but only 1.3% and 1.5% in France and Germany, respectively. McKinsey says that the U.S. tech sector accounts for more than a quarter of the entire economy's productivity growth. (Some studies suggest it is much higher.) In contrast, a smaller IT sector generates less than 20% of productivity growth in Europe.

At the same time, says Dirk Pilat, senior economist at the OECD in Paris, fewer new businesses—most of which generate strong productivity growth if they survive—are created in Europe. "You just don't get the same productivity impulse from new companies here," he says.

Europe also spends less on research and development—about 2% of GDP, vs. nearly 3% in the U.S. Spending on R&D usually boosts productivity, too, as new processes and easier-to-make products flow from the labs to the assembly line. And many of the big European R&D spenders, such as Novartis, are shifting more of their R&D to the U.S. to be closer to their biggest market. German-based BASF, for example—the world's largest chemical company—is not only trimming R&D spending but also deciding whether to move its genetically modified crop research across the Atlantic. Such moves mean that the U.S. economy benefits more than Europe does from any productivity payoff that comes from R&D.

Even if IT and R&D expanded dramatically in Europe, it's not clear whether they would have the intended effect. The biggest psychological impulse to boost productivity is the survival instinct: the drive to be smarter, faster, bigger. In Europe, numerous barriers to competition mute that instinct. "Europe seems to be covered in a warm blanket, which protects the average but smothers the excellent," says the Netherlands' Brinkhorst.

Take Germany. The legal separation of commercial, savings, and cooperative banks in Germany means that there has been little financial sector consolidation. German banks have invested heavily in information and communication technology and developed highly efficient payment, customer-relations, and online-banking systems. But without the chance to exploit the economies of scale that come with consolidation, they can't derive maximum productivity benefits from it. The average German bank's productivity is 13% lower than its U.S. counterparts as a result.

There are even productivity-busting restrictions in Britain, the fastest-growing big economy in Europe. British retailer Tesco PLC over the past 10 years has spent heavily on IT. Retailing analysts estimate that Tesco's labor productivity growth has been about 1% a year higher than the recent British average for the past five years. "Their distribution systems are as tight as they can be," says Nick Isles, associ-

THE EFFICIENCY PROBLEM

Europe trails the U.S. in productivity—and IT outlays

PHOTOGRAPH BY TOM WEGNER/LAIF; CHART BY RAY VELLA/BW

ate director at the Work Foundation, an independent research consultancy in London. That benefits Tesco's efficiency because it delivers the right goods at the right time.

Yet for all its success, Tesco hasn't been able to chalk up as many productivity gains as it could. One reason, say industry experts: Tough British planning laws make it harder to open large new supermarkets than in the U.S. That means Tesco can't fully benefit from productivity gains by setting up new shops and achieving the economies of scale it would in a less regulated environment.

Could Europe have a productivity spurt? Yes. Take what happened in the German electricity and gas market when it was liberalized in 1998. Wholesale prices fell, forcing power generators to improve their traditionally low productivity levels by investing heavily in IT—$5.6 billion in 2000 alone. Annual productivity in the sector has risen 3.5% since. By contrast, Electricité de France, a state-owned virtual monopoly, has invested just a fifth as much in IT in recent years as has the German power sector. One result, say consultants: Labor productivity growth at EdF is less than a sixth of German levels.

Labor-market reforms could improve efficiency

Europewide deregulation helps, too. When the regulations governing commercial trucking were harmonized in the late 1990s, managers were able to reduce red tape and invest in bigger, more efficient vehicles. Some European companies and countries even outperform their U.S. rivals. European mobile-telephone operators tend to be far more productive than most U.S. providers. Low-tax, well-educated, high-tech Ireland boasts productivity growth rates on a par with or above U.S. levels. Britain is improving manufacturing output per worker by stressing training. What's missing is that systematic surge in IT spending, coupled with serious labor-market reforms, that would change the dynamic in all of Europe. Until that happens, progress will come in fits and starts. ■

–By David Fairlamb in Frankfurt and Andy Reinhardt in Paris, with Laura Cohn in London

GERMANY

A NEW DRIVER FOR MERCEDES-BENZ?

The star who turned around Daimler's truck unit has the inside track

IN THE CORRIDORS OF POWER at DaimlerChrysler's Stuttgart headquarters, the bets have been placed, and the buzz is intense. Insiders say the front-runner to succeed Mercedes-Benz boss Jürgen Hubbert, who will retire by next spring, is Eckhard Cordes, the head of Daimler's commercial-vehicle unit, which ranks No. 1 worldwide with $35 billion in annual sales. The jockeying for power at Germany's leading industrial group isn't over, and a dark-horse candidate may yet win the job. (An announcement is expected within weeks.) Still, Cordes' rehabilitation of the truck, bus, and van business has put the 28-year company veteran in the spotlight.

Whether or not he becomes Mr. Mercedes, Cordes, 53, remains a strong contender to succeed embattled DaimlerChrysler Chief Executive Jürgen E. Schrempp, 59. During a turbulent 2003, when big losses at Chrysler and Mitsubishi Motors pushed Daimler's net profit down 91%, Cordes steered the commercial-vehicle unit to a $1.1 billion operating profit after two years of red ink. Even in April as angry fund managers called for Schrempp's resignation, several singled out Cordes for a job well done.

Cordes' turnaround in commercial vehicles could give him an edge in the race for the top job at $64 billion Mercedes-Benz. The premium Mercedes unit generates 55% DaimlerChrysler's operating profit, b now struggling to keep its top-dog tus. Mercedes' sales fell 3.3% worldv in the first half of 2004 as BMW ed ahead. Quality problems continue to nish a once-impeccable image, and siders say Chrysler and Mitsubishi h drained the management talent an

BIO

Eckhard Cordes

BORN Neumünster, near Hamburg

AGE 53

EDUCATION MBA and PhD in political science from University of Hamburg

FIRST JOB Management trainee at Daimler-Benz, 1976

CURRENT JOB Chief of Daimler's $35 billion Commercial Vehicles Div. and member of board of management

BIGGEST ACHIEVEMENT Slashing $900 million in annual costs at truck unit Freightliner and restoring it to profitability

Data:

rces needed to keep Mercedes out in t. On July 12, Hubbert announced cedes must cut $620 million in pro- tion costs or transfer manufacturing ne new C-Class car to Bremen, Ger- ny, or South Africa, a move that ld wipe out 6,000 jobs in Stuttgart. e cost-cutting drive at Mercedes is serious," says one auto consultant, ng that Cordes has proven he can d a knife.

hen Cordes took over at the truck in late 2000, Freightliner, the p's huge U.S. operation, was skid- into the red. As the U.S. truck market nk by some 50%, Cordes shut three ts and halved the workforce in two s—all without a major union walk- "Our target is crystal clear. It's not to fter additional market share. What ters is the bottom line," he says.

ITICALLY SAVVY

SE ASSOCIATES describe Cordes as unpretentious manager in a land- e of oversized egos. But he is also tically savvy. Despite the heat rempp took over the merger with ysler—a deal Cordes helped engi- —he remains loyal to his boss. ing a boardroom battle in May over ilout for Mitsubishi, Cordes was of the few who backed Schrempp's to recapitalize the Japanese car- ker. He still argues the merger with ysler can deliver gains from a e-spanning presence. "Nothing ly went wrong," says Cordes, gh he concedes that "perhaps we ed expectations too much."

ordes' loyalty could help in any ma- vering before his boss's departure. rempp is still in command, but in- rs say he'll likely step down well re his contract expires in 2008. , Cordes has spent most of his ca- poring over balance sheets and ing acquisitions: He has only been ctly responsible for profits at the k unit. And as the board member in rge of Asia, he bears ultimate re- nsibility for the Mitsubishi debacle. there's no question he threw him- into the truck business. Twice a he drives some 400 miles behind wheels of seven-ton rigs to test his products against those of his ri- . Keeping a monster vehicle under rol—that's a good metaphor for a CEO's job. ■

–By Gail Edmondson in Stuttgart

nessWeek online For an interview with Cordes, go to essweek.com/magazine/extra.htm

COMMENTARY

BY DEXTER ROBERTS

China's Credit Crunch

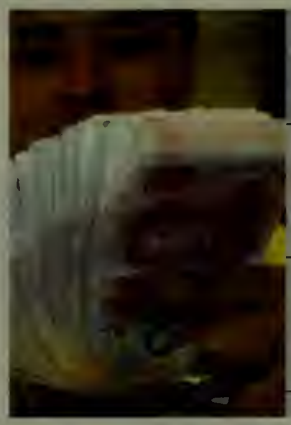
Beijing's go-slow policy is strangling private business

NO INTEREST RATE increase. That looks like one of China's big accomplishments in its quest to cool off the economy. By ordering the banks to stop lending to certain sectors, the authorities have slowed the growth in investment in steel, auto, and real estate—without raising the benchmark bank lending rate of 5.31%. In theory, that means companies with good projects can still borrow at affordable rates.

Problem is, that theory ignores the reality on the ground. The cost of credit in China is up—way up—but mostly for private companies. Yes, fewer state enterprises are getting loans these days, but those they get are at the official rate. Private companies, by contrast, now typically pay rates of 20% or more on the gray market—if they can get credit at all. "It's an undeniable truth that private companies have been hit harder" by the restrictive credit policies, says Dong Tao, chief regional economist at Credit Suisse First Boston in Hong Kong. In May, Tao says, official bank lending to private companies fell by 17% year on year, while overall loans surged by 19%.

The gathering credit crisis for the private sector is one more blow to the part of the economy that Beijing should be encouraging the most. Today, the non-state sector accounts for perhaps 60% of China's gross domestic product and 70% of total employment. But as Beijing tries to slow the economy, these private upstarts have to scramble for funds instead of focusing on their businesses. Some simply bribe bank officials to jump to the front of the lending queue, which amounts to a de facto rate increase (and many businessmen say bribes are bigger now). And there's an assortment of middlemen ranging from well-heeled state enterprises to illegal (though often tolerated) private credit unions. They're all willing to lend to private businesses—at a steep premium.

Punishingly high rates aren't the only cost to the private sector. Since many of the private loan operations are illegal, Beijing can't control or regulate their lending. That means greater risks for everyone involved. And the game is getting tougher, with some gray market lenders refusing to roll over loans to private companies. "If the government relied more on market mechanisms [such as interest-rate hikes] to tighten credit, it would be a fair game for the state and private sectors," says Xu Xiaonian, a professor of economics at the China Europe International Business School in Shanghai.



A Costly Reality

5.31% China's official interest rate for loans

20% Effective rate from informal lenders

Data: *BusinessWeek*

What's to be done? For starters, Beijing could raise rates for everyone and lend based on merit. More important, China should consider legalizing the gray market in finance. Creating lawful and reliable alternate sources of corporate funding would pressure China's state banks to start making loans based on sound business considerations rather than connections. Only then will China stop misallocating capital, the first step in creating the kind of balanced growth it says it wants. ■

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ITED BY ROSE BRADY

France: Chirac's Protégé s No Poodle

ENCH POLITICS TRADITIONALLY PITS the country's left wing, sup-rted by national labor unions, against the more business-endly right wing. Not now. The real action is a struggle for ntrol of France's ruling center-right—and it's emerging as a y European political battle to watch.

ncreasingly isolated within the Elysée ace, 71-year-old President Jacques irac is facing an unprecedented chal-ge from his onetime protégé, Nicolas kozy. The 49-year-old Finance Minister not hiding his ambition to stop Chirac m running for a third term in 2007 and nts to run for the top job himself. "A r ago, nobody thought Sarkozy would a credible presidential candidate," says ilippe Manière, executive director of stitut Montaigne, a Paris think tank. ow he has gained complete credibility." lthough Chirac is a wily politician with re than one trick up his sleeve, many be-e it will be difficult for him to keep the er hand against kozy. Voters seem reasingly disen-nted with the vet-n politician, who t became Prime nister in 1974. irac's conservative ion for a Popular vement party took rubbing in region-polls last March l in European Par-nent elections in e. A further blow ne in mid-July, en Chirac loyalist in Juppé stepped n as UMP chief six months after receiv-a suspended sentence on corruption rges. Party rank and file are now likely to k Sarkozy if, as is likely, he makes a bid head the UMP.

RIVALS President Chirac and Finance Minister Sarkozy

Control of the UMP would be vital to kozy's goal of becoming the next center-ht presidential candidate. If he succeeds, ould spell the end of the narrow-based ontocracy that has dominated French itical life for the last generation and could usher in real change. While Chirac has said that France's costly 35-hour week legislation cannot be repealed, Sarkozy has called for its "radical reform."

Signs of a Shift

CHIRAC'S TIRELESS EFFORT to promote a Paris-Berlin political and economic axis has been relentlessly attacked by Sarkozy, who argues that France should look to more dynamic Britain, Spain, and the U.S. as models, rather than to slow-growth Germany. Sarkozy's rise could also be a harbinger of broader political shifts at the heart of "Old Europe." A similar process looks to be under way in Germany, where dissatisfaction with Chancellor Gerhard Schröder's halfhearted reforms is boosting the prospects of victory in mid-2006 for center-right opposition leader Angela Merkel. She could take office even earlier if the center-left continues to get beat in regional elections. Like Sarkozy, who never attended the elite Ecole National d'Administration, Merkel is an outsider—as a native East German and a woman.

Sarkozy does face challenges. As President, Chirac still can dismiss him at will. But such a move could backfire since Sarkozy is considered the government's most effective minister. Sarkozy's team thinks Chirac has little choice but to cut a deal anointing the younger politician as leader of France's center-right. The 2007 race may be a long way off, but the campaigning has begun—and Sarkozy more than ever looks like the horse to watch. ■

–By John Rossant in Paris

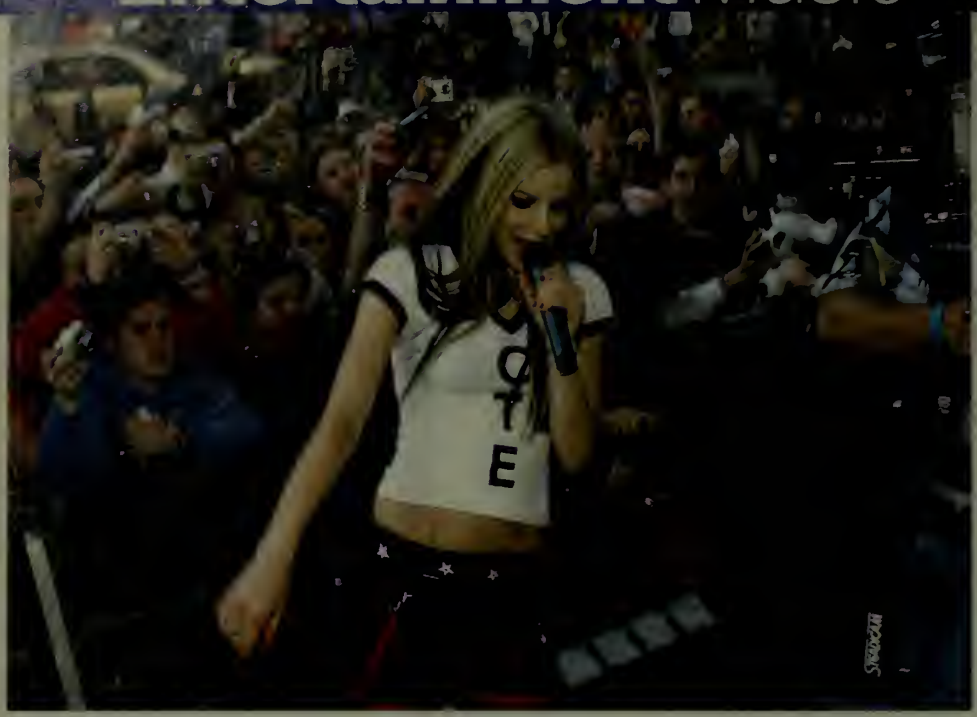
GLOBAL WRAPUP

A NEW BLOW TO INVESTORS IN RUSSIA

RUSSIAN OIL company **Yukos** is about to be destroyed. That's the conclusion many investors in Russia are drawing, after court bailiffs said on July 20 that they plan to sell Yukos' main production subsidiary, Yuganskneftegaz, to pay $3.4 billion in back taxes. The announcement stunned analysts, who say the subsidiary is worth several times the value of the tax debt. Investors now fear a rigged sale to ensure a knock-down price, with companies linked to the Kremlin the likely beneficiaries. Yukos's share price plunged 25% on July 20 and 21.

PINOCHET MAY FACE PROSECUTION

A U.S. SENATE investigation may have accomplished what several civilian governments in Chile couldn't—uncover evidence of wrongdoing by former dictator **Augusto Pinochet** that could lead to his punishment. A Senate report recently found that Pinochet, who ruled Chile with an iron fist for 17 years, hid as much as $8 million in secret accounts and offshore companies set up by Washington-based **Riggs Bank** from 1994 to 2002. Now, Pinochet, 88, faces investigation by the Chilean Congress and tax authorities. News of the accounts shocked Chileans because the retired Army general had always maintained a noncorrupt image—despite the tortures, murders, and disappearances of political opponents during his rule. In May, a Santiago court stripped Pinochet's presidential immunity. That clears the way for a possible trial on human-rights or tax-evasion charges—if Chile's Supreme Court rules he's mentally and physically fit enough.



BRIGHT SPOT Chart-topper Avril Lavigne helped push the company's sales

It Seemed Like A Good Idea...

A bad Napster deal is still giving Bertelsmann nightmares

IN EARLY JULY, THE MUSIC INdustry received its first bit of good news in a long time. Sales for the first half of 2004 showed a 7% increase after several years of losses. Nobody was happier than the folks at BMG, the music unit of German media giant Bertelsmann whose U.S. market share rose four percentage points, to 20%, largely on the success of chart-toppers such as Usher, Outkast, and Avril Lavigne. The gains come after the industry's bleakest era, when digital piracy crippled BMG and other music stalwarts.

Now, though piracy has abated some, a legacy from the old days could deliver another devastating blow to Bertelsmann. A July 14 decision by U.S. District Court Judge Marilyn Hall Patel will force the media company to defend itself against two lawsuits seeking as much as $17 billion in damages. In 2000, Bertelsmann struck a partnership with illegal file sharing service Napster to keep it alive in hopes of converting it to a legal venue for online music sales. Patel denied a motion by Bertelsmann to throw out the suits, which claim that when Bertelsmann lent Napster more than $85 million over two years, it deliberately prolonged Napster's ability to traffic in millions of illegally copied tunes. The irony: At the same time, BMG was suing along with others to put Napster out of business. "[Bertelsmann] flouted copyright law," says Carey R. Ramos, a partner at Paul, Weiss, Rifkind, Wharton & Garrison, who is representing songwriters and publishers. Another suit by music rivals EMI Group PLC and Universal Music Group makes a similar claim.

Judge Patel's judgment doesn't mean the claim is true—and privately held Bertelsmann, with sales in 2003 of $20 billion, strongly denies liability. facts simply do support the al tions of contro Bertelsmann's p Bertelsmann ge counsel Ulrich Koch says. EMI and versal officials declined to comment.

But having the cases proceed to finding creates a huge headache for telsmann CEO Gunter Thielen, wh ready has plenty of them. Tepid ad worldwide as well as slow growth in rope have forced massive cost-cuttin the company's far-flung media hold which include Europe's RTL Group te sion and the Gruner + Jahr magazine Such measures were just enough to res a meager profit of $47 million in the quarter on sales of $4.55 billion, vs. a $ million loss the year before.

"BIG BURDEN"

BERTELSMANN MANAGERS are dealing with a series of local crises, suc disarray in the U.S. magazine operati troubled by management turnover an ascoes such as the noisy demise last ye *Rosie* magazine. "If the company is li for half or even a quarter of what th [copyright lawsuit] plaintiffs are seek it's a big burden," says veteran media a lyst Harold Vogel.

Even if Bertelsmann doesn't wind paying big money, the case is a h distraction for top brass. Former Thomas Middelhoff, forced out in 20 was the most vocal advocate for the N ster loan. But current CEO Thielen other top brass such as CFO Siegfi Luther took part in decision-making b then. They and other execs, including mer Justice Dept. antitrust chief Joe Klein, briefly Bertelsmann's CEO for cor rate services, could be cal to testify if there is a trial

CEO Thielen has imposed massive cost-cutting

How great is the com ny's risk? The plaintiffs c tend that following the f loan to Napster in Nove ber, 2000, Bertelsmann k the file-sharing service and running even thoug was violating copyri laws. For every illeg swapped song, lawyers there's a maximum pen of $150,000. Bertelsman likely to argue that, far fr controlling Napster, founded by 17-year- Shawn Fanning, it looked helplessly as the startu managers argued bitte

he Sour Notes eep Coming

e growing challenges ing German media nglomerate Bertelsmann:

- ge legal exposure of up to $17 on from lawsuits involving onetime ner Napster
- arginally profitable book clubs threats to the business model
- dustrywide ad slump that's mering its big magazines unit
- per-management turmoil that's ing morale as well as executive uiting
- erce competition in European TV

g each other. By the time Bertels- exec Konrad Hilbers became CEO 01, the service was nothing more Web site, the company is expected tend. Judge Patel ordered Napster down in July of that year. A legal ter now operates under software r Roxio Inc., which bought its assets f bankruptcy in 2002.

rtelsmann's hope is that, after a pe- f extensive pretrial fact-finding, the will be tossed for lack of evidence. ertelsmann also has to worry about untled former execs who have little tive to defend their former boss. ss Zelnick, BMG's CEO until De- er, 2000, who opposed the Napster is among those cooperating with laintiffs, *BusinessWeek* has learned. ck declined comment.

e lawsuit is unlikely to affect BMG's ed venture with Sony Music Enter- ent, which won European regula- approval on July 19. But as BMG nues to thrive, and CEO Thielen s to restore healthy profits compa- de, the Napster lawsuit is anything oothing background music. ■

–By Jack Ewing in Frankfurt and Tom Lowry in New York

The Pitcher Who May Steal America's Heart

A star turn on the mound in Athens could turn Jennie Finch into a dream endorser

SHE'S 6 FEET TALL, blonde, beautiful, and at the top of her game. Unfortunately for her commercial prospects, the sport isn't tennis, and she isn't Wimbledon champ and *Sports Illustrated* cover girl Maria Sharapova. But Jennie Finch, who pitches underhand at 72 mph, is generating plenty of buzz as she heads to Athens with the U.S. Olympic Women's Softball team, a solid favorite to win a gold medal.

Finch has signed on as a spokesperson for companies including Sprint, Bank of America, Sealy, 24 Hour Fitness Worldwide, and sunglasses brand Bollé. Finch, 23, whose first brush with fame followed 60 straight victories at the University of Arizona, also has a four-year deal with sporting-goods maker Mizuno Corp., worth up to $100,000 a year. Mizuno sells a line of Finch bats, gloves, and shoes.

HEAD-TURNER Finch's looks have made headlines

For Finch and her handlers at sports agency Octagon Worldwide, the challenge will be to stay hot after the Olympic flame is doused. Even presuming the team wows 'em in Athens, few Olympic heroes have pulled off that trick, especially in sports that virtually disappear between Games.

But Finch's appeal may be the kind that sticks. First off, her timing is impeccable: She's stepping into the spotlight when the universe of potential American Olympic stars is small. Except for swimming phenom Michael Phelps, sprinter Maurice Greene, and the men's basketball and women's soccer teams, the U.S. delegation lacks luster. The men's baseball and soccer teams didn't even qualify for Athens.

Finch's looks are also turning heads. A 2003 ESPN poll anointed the La Mirada (Calif.) native the most attractive female athlete. And Finch is one of *People* magazine's "50 Most Beautiful People of 2004." Says the homespun fireballer: "The whole sexiness thing—I don't know if I'm comfortable with that." Finch prefers to let her fastball do the talking. "You can't go into the Olympics thinking: 'If I pitch a no-hitter, [endorsement deals] will happen.' I'm an athlete. If you do the right things on the field, it'll transcend into every part of your career," she says.

Sell-out exhibition games are building interest in Finch and her team, but with the only existing pro-softball league in just its second year, even getting the gold medal won't lead to lucrative playing contracts. Finch estimates "two or three" softballers scratch out a living from the game and endorsement deals.

Finch, who's one of them, also has regular gigs on ESPN's *Women's College World Series* and as cohost of Major League Baseball's *This Week in Baseball*. And deals such as her two-year agreement with health chain 24 Hour Fitness will help pay the bills. But more than money is at stake if she can blow away the competition and wind up as America's Olympic sweetheart. ■

–By Mark Hyman

COMMENTARY

BY AMY BORRUS

The Case of the Vanishing 401(k)s

Are workers' suits over retirement plans forcing Corporate America to improve the

GARY S. DREADIN cheered when his former Enron Corp. boss Kenneth L. Lay was indicted on July 8. The 39-year-old communications technician for Florida Gas Transmission Co., an Enron joint venture, lost almost $500,000 in his 401(k) and employee stock ownership plan accounts after the energy giant declared bankruptcy in 2001. Encouraged by Lay in Webcasts to employees, Dreadin says, he had poured all his retirement savings into Enron stock. Today, Dreadin is a plaintiff in a class action brought against Enron and Lay on behalf of its workers, whose retirement accounts took a hit of more than $1 billion. "I realize I'll never get back all the money I lost," he says. "But I'll sleep better at night if some of the money comes from Ken Lay's pocket."

Dreadin may have a tough time collecting much from Lay, who's being sued by plenty of others as well, but he stands to recoup at least a fraction of his losses. In May, 20,000 current and former Enron employees struck a tentative $85 million settlement with Enron's retirement-plan administrators and its outside directors. The plans' insurers will pick up the tab, unless creditors in Enron's bankruptcy try to grab it first. The employees' claims against Lay, other executives, and Enron itself are still in court. Lay lawyer Mike Birrer says his client had no responsibility for the 401(k).

The lawsuit is among more than two dozen filed in search of compensation—but mostly revenge—for the losses employees racked up in their 401(k)s during the stock market bust. Although few large cases have yet been decided, out-of-court settlements are starting to mount, with Enron's deal the biggest so far (table). Most of the suits target scandal-plagued corporations, though the courts have allowed a few cases to go forward against companies, such as Sprint Corp., that haven't been accused of wrongdoing.

While the rash of lawsuits may not restore much of employees' lost savings, they're already having one salutary affe tery companies have begun making it easier for workers the company stock in their 401(k)s. They're worried th courts could find them responsible if their 401(k)s lock much company stock and don't sell when the shares sour—a common practice. "It's not a good idea to invest a part of your retirement money where you work—it's too eggs in one basket," says Martha Priddy Patterson, direc Deloitte Consulting LLP's human capital practice.

Most of the suits filed so far allege that employers vi their fiduciary duty to 401(k) holders. Enron employees a that the company, whose 401(k) had 62% of its assets in shares, should have taken steps to protect workers. Once utives knew the company was in trouble, the plaintiffs co the 401(k) should stopped matching emp contributions with su imprudent investmer also should have ad employees to stop inve in Enron shares.

ENRON'ED Technician Dreadin lost almost $500,000

Employees' Revenge

Workers at scandal-ridden companies are suing over 401(k) losses—and winning:

COMPANY	SETTLEMENT (MILLIONS)	DATE
WorldCom	$51	July, 2004
Enron	85	May, 2004
Global Crossing	79	Mar., 2004
Lucent	69	Dec., 2003

Because 401(k) plans serve two s times conflicting goals—retirement se ty and employee stock ownership— gress granted them key exempt Unlike traditional pension plans, 40 don't have a 10% cap on holdings ir one stock, and fiduciaries are not req to diversify assets.

After Enron's collapse, Congress deb ways to prevent loading up on too n company stock but never acted. Ab pressure from Washington to dive many 401(k) plans remain chock-fu employer stock. A 2003 Hewitt Assoc study found that company stock aver 40% of account balances for workers had employer shares. But now, facing tential lawsuits, employers are startir shorten or even eliminate holding per on company stock. Today, 36% of 4C plans let employees diversify out of employer-match shar any time, up from just 15% in 2001, according to Hewitt.

So why, after all the corporate scandals, don't more emp ees diversify their 401(k)s? Enron workers' losses don't onate because "people still think, 'It won't happen to me,'" Barbara J. Hogg, who studies 401(k)s at Hewitt. Enron surv Dreadin learned the hard way. Now, instead of contributin a 401(k), he's putting his savings into real estate.

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CULT BRANDS

The *BusinessWeek*/Interbrand annual ranking of the world's most valuable brands shows the power of passionate consumers

CASEY NEISTAT, 23, IS A SELF-PROFESSED APPLE JUNKIE. Along with his brother, Van, he is building his filmmaking career with the company's iMac computers and editing software. He usually leaves his Manhattan apartment with a sleek iPod plugged into his ear. So last year, when the Neistat brothers discovered the digital music player's batteries were irreplaceable and lasted just 18 months, they made a film called *iPod's Dirty Secret* and launched a protest Web site. Apple Computer Inc. addressed the problem. Now Neistat insists that the protest was an act of love: "We made that film because we believe in the brand so much."

Such loyalty flies in the face of conventional marketing wisdom. A customer spurned, the logic goes, is a customer lost. But these days the relationship between brands and their customers has become much more complex. For one thing, consumers simply know more than they used to. The Internet opens up a wealth of information, allowing for instant price and quality comparisons. But consumers demand more from the brands they love than simple reliability; passionate consumers want their brands to become a form of self-expression. Increasingly, consumers are customizing products and services to achieve that—whether it's tailoring colors on a pair of sneakers from Nike Inc. or adding items to their personal to-watch list on eBay. Instead of arms-length customers, they're beginning to act like and feel like owners or members of a community. They no longer passively consume. Through the Internet, they can talk back and talk to one another. They can ignite a groundswell of positive buzz or spawn a revolt. As Peter Weedfald, senior vice-president for strategic marketing and new media at Samsung Electronics North America, puts it: "Consumers are empowered in a way that's almost frightening."

The World's 10 Most Valuable Brands

A newcomer, Toyota, breaks into the Top 10, wh big-name consumer brands come under attac

RANK	BRAND	2004 BRAND VAL (BILLIONS)
1	COCA-COLA	$67.39
2	MICROSOFT	61.37
3	IBM	53.79
4	GE	44.11
5	INTEL	33.50
6	DISNEY	27.11
7	McDONALD'S	25.00
8	NOKIA	24.04
9	TOYOTA	22.67
10	MARLBORO	22.13

Data: Interbrand Corp., J.P. Chase & Co., Citigroup, Morgan Stanley

ICONIC From Beijing to Boston, iPod users have formed a bond

is seismic shift in clout from companies to their customers ating opportunities, especially for younger brands that up with the Internet and have become adept at building ommunities. Meanwhile, some traditional brands, such as Cola and Microsoft, are struggling to retain their mam- leads in a market where consumers increasingly resist they see as bland ubiquity and a surfeit of power.

ere have always been cult brands, mostly smaller labels own to the masses. But these days, building cults or at strong communities, is a widespread strategy. No wonder anies that are able to instill a sense of ownership in near- ical customers showed the biggest gains in our fourth an- ranking of the 100 most valuable global brands. The loyal, metimes nagging, band of true believers behind No. 43 Ap- combined with tremendous success of the iPod—helped llar value of the brand jump 23.7%, to $6.9 billion, over st year. That was the biggest increase in this year's rank- which is compiled in partnership with leading brand con- cy Interbrand Corp. A dollar value is calculated for each l using a mix of publicly available data, projected profits, ariables like market leadership (page 68).

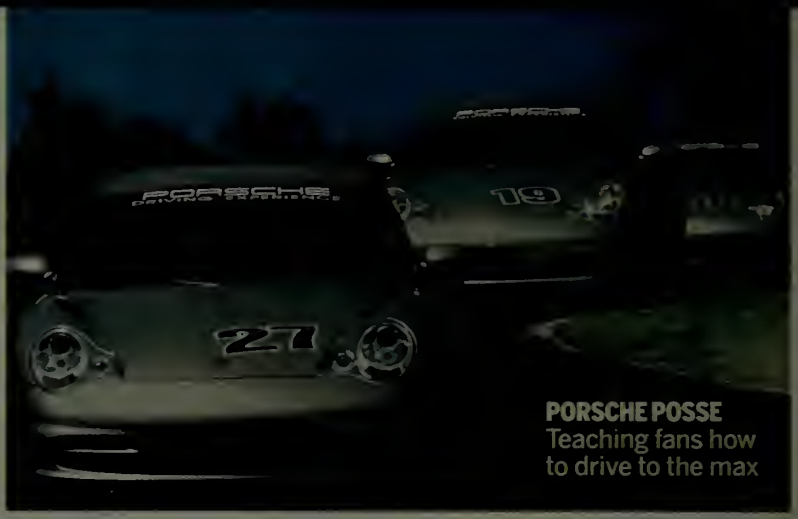
ple was hardly alone in enlisting recruits. EBay makes its at No. 60. Fellow hot property Samsung Electronics, , jumped 15.7% in value to $12.6 billion—a move that -based global marketing chief Eric B. Kim attributes to ding communities around our brand." Along with honing a high-end image with its feature-packed cell phones and flat-panel TVs, it nurtures loyalty with events for users. Yahoo! and Amazon.com, Nos. 61 and 66, respectively, also made significant gains. But success isn't limited to the young. Cult icon Harley-Davidson, No. 41, climbed despite having been founded more than a century ago. While the value of those brands is a fraction of the top-ranked $67.4 billion Coca-Cola brand or No. 2 Microsoft, with $61.4 billion, those behemoths have lost brand value over the past year. And they, too, have started to recognize the need to nurture stronger ties with consumers. Witness moves by Microsoft to hold mini trade shows in airport lounges for consumers and the soda giant's creation of hip "Coke Red Lounges" for teens in suburban malls.

Group Think

THE GOAL: TO FOSTER A SENSE of shared experience and of belonging. Starbucks Chairman Howard D. Schultz balks at the notion that his brand, which ranks 98th in our survey and jumped 12% in value this year, is about selling various iterations of coffee. Says Schultz: "The product is the experience." His shops may sell latte, but what people really crave is the hip, relaxed ambiance, the music, even the baristas who remember the regulars' favorite concoctions. Sounds crazy? Not to student Amy Berkman. Approach her at her favorite New York City outlet and she lets forth a stream of opinions on everything from

ideal chair configurations in the store to the type of mustard they should use on their ham-and-cheese sandwiches. "Something more tangy and grainy would work better," she says, sipping on her daily chai latte. She cares because this is where she hangs out with her friends. Berkman doesn't like coffee; she likes the experience of being at Starbucks.

The brands that have managed to build cultlike followings have done so by being, well, cultlike, at least in some aspects. They are self-consciously different from rivals. They're bound by a set of clearly defined and rigorously enforced values. And they fulfill a range of needs for their members—er, customers. The fastest-growing ones often project a an aura, an attractive group identity. Conjure up an image of an Armani customer or a Porsche driver and it will evoke a set of personality characteristics as much as it evokes a product preference. They also beget proselytizers—customers who will chat up the brands to their buddies, set up Web sites, attend events, and proudly identify themselves as adherents, according to strategist Douglas Atkin of ad agency Merkley & Partners, who recently wrote *The Culting of Brands*. Nobody has to pay them. They are owners as well as customers.



PORSCHE POSSE
Teaching fans how to drive to the max

Cultlike brands are self-consciously different from their competitors

The classic example of a cult brand is Harley-Davidson. The 101-year-old brand gained 4% in value this year to $7.1 billion. Sure, there are new models like the sleek V-Rod line and fresh features aimed at wooing women, but the real buzz comes from the 886,000 members of the company-sponsored Harley Owners Group. They're the ones who organize rides, training courses, social events, and charity fund-raisers. They pore through motorcycle magazines and wear the Harley-branded gear to feel more like rugged individualists and outlaws when they hit the road on weekends. A quarter of a million of them descended on Milwaukee last Labor Day to celebrate the brand's centennial. No wonder more than half of new Harley sales are to current customers who are trading up. The brand is self-reinforcing.

It doesn't take a cool category like motorcycles to yield a cult brand. Some are found in far more mundane sectors—like furniture retailing. In Shanghai, Wang Jian Shuo runs a Web blog that, among other things, delves into his likes and dislikes with No. 40 Ikea, the Swedish furniture chain that offers modestly priced, ready-to-assemble furniture with cute names. He writes about everything from the 12¢ ice cream cones in the store cafeterias to how, as a newly graduated student in 1999, he spent his first month's salary on a "Billy Bookcase." Notes Wang: "Ikea seems to know my life better than any oth niture brand." Among those posting responses to his mu are a Malaysian fan who started his own Ikea forum an other who makes jokes about Swedish meatballs.

Such exchanges underline a key aspect of brand com ties in the modern age: They evolve in ways that the head often can't control. Newly empowered consumers can a priate and manipulate the brand in whatever way they The Neistat brothers' anti-iPod Web site has generated 1.4 lion hits from around the world. And it's not just brand who can make a difference—or inflict damage. Witness th cess of *Super Size Me*, in which documentary filmmaker M Spurlock chronicled his decline in health while eating me McDonald's for 30 days in a row. Although it denies any McDonald's Corp. recently did away with the Super Size option. They called it a menu simplification.

The key for brand builders give empowered consumers a product and the tools to use it ever they want. Jeffrey P. B chief executive of Amazon. whose brand value grew 22% lieves there is a distinct comm built around his brand, though it's now used by more 30 million people worldwide. him, community is defined "neighbors helping neigh make purchase decisions." means allowing negative custo reviews, even if it sabotages a p ble sale. It meant halting spen on conventional advertising year to funnel money into cu prices and improving service i belief that the community i

The Big Winners

It's the year of the iPod (Apple). Meanwhile, Net brands (Amazon, Yahoo) extend their reach, a Korean electronics juggernaut (Samsung) just gets stronger, and a London outfit (HSBC) stakes its claim as the world's local banker.

RANK	BRAND	2004 BRAND VALUE (BILLIONS)	2003 BRAND VALUE (BILLIONS)	PERCENT CHANGE
43	APPLE	$6.87	$5.55	+24%
66	AMAZON.COM	4.16	3.40	+22%
61	YAHOO!	4.55	3.89	+17%
21	SAMSUNG	12.55	10.85	+16%
33	HSBC	8.67	7.56	+15%

Data: Interbrand Corp. | P. Chase & Co. Citigroup Morgan Stanley

INTO IKEA
Everyone loves the kids' section

ld spread the word. What Bezos does control is the range quality of his site's offerings. "The thing that we did early s that we made it very easy for people to find very obscure lucts," notes Bezos. "If you're not doing something that ple will remark on, then it's going to be hard to generate d of mouth."

lass Customization

IE COMPANIES ARE using mass customization to bind r customers ever more tightly to their brands. The efforts nd beyond the individualized Web pages that characterize sites like Amazon.com and eBay. It means allowing cus- ers to set up fan sites on the Web or personalize items. e companies, like No. 18 Honda Motor and Nike, offer s to help customers put their imprint on a product—such hoosing unique color combina- s and messages for their akers. But relinquishing control proved to be hard for some keters. No. 6 Walt Disney and 82 AOL have famously chased n fans for unauthorized use of yrighted material. As brand turist" Andrew Zolli argues: hen you get to the point where re suing your customers over r use of your brand, it's time to nge your business model."

ven brands that have largely wn through acquisitions and rt pricing understand the im- tance of building a distinct im- and fan base. As Peter String- n, group general manager of C Holdings PLC bank in London notes: "Nobody needs a new anything anymore." Instead, what has allowed No. 33 HSBC to jump 15%, to $8.7 billion, this year is clear differentiation as "the world's local bank" with a flavor that varies by location. On Jan. 28, for example, it kicked off the rebranding of newly acquired Mexican bank GF Bital with a free live concert in Mexico City for 10,000 people by pop singer Luis Miguel. In New York, it grabbed attention by offering free taxi rides in a cab emblazoned with the bank's red and white logo to any passenger with an HSBC bank card.

In contrast, some old-line brands seem to be coasting on sheer size rather than an ability to forge a unique relationship with customers. Even brands that have enjoyed decades of success and have instant recognition with consumers can lose some sparkle. Over the past year heavyweights like Microsoft, Coca-Cola, and Walt Disney saw their brand values erode. Others, like Finnish mobile-phone giant Nokia Corp., No. 8, are struggling to regain momentum. "Nokia used to differentiate but I don't think people would know what to associate with it now," argues Jan Lindemann, Interbrand's global director of brand valuation. Nokia's head of global branding, Tapio Hedman, admits that "some young people may find Nokia too everyday, too middle of the road." But he disputes the notion that his brand could plummet 18% over 12 months, as it did this year in our ranking, arguing that brand equity takes years to win and lose. "Once you have it, it's a bit like insurance," says Hedman. "It's not likely to be eroded very fast unless you make one mistake after another."

That may be a dangerous point of view to take. Just ask Royal Philips Electronics' new chief marketing officer, Andrea Ragnetti, who blames the lack of buzz around the Dutch electronics giant, which dropped 2% in the rankings, to No. 65, on years of underinvesting in the brand. "It's seen as a dull, solid, reliable brand but nothing really special, nothing sparkling," says Ragnetti, who is currently trying to narrow the brand's target demographics and recast its message.

That doesn't mean big brands can't connect with customers. Even massive players like No. 4 General Electric Co., which saw its brand value gain 4%, to $44.1 billion, can adopt a fun, flirty style. The most popular section on the company's Web site is the "GE Pen," which allows users to doodle in a variety of colors and styles before e-mailing their handiwork to a friend. Since launching last year, it has received more than 43 million impressions. When the site went down for a few days to upgrade, the company was deluged with e-mails that asked where it had gone. Does it help the company sell more ovens or advertising on NBC? Probably not. But it certainly gives users a warmer feeling about GE. These days, anything that makes fans out of fickle consumers can be priceless in building a brand. ■

–By Diane Brady in New York, with Robert D. Hof in San Mateo, Calif., Andy Reinhardt in Paris, Moon Ihlwan in Seoul, Stanley Holmes in Seattle, Kerry Capell in London, and bureau reports

The Big Losers

Technology and competition march onward, battering once-sterling brands in consumer photography (Kodak), video games (Nintendo), cell phones (Nokia), online service (AOL), and autos (Ford). Consumers ask: What's so special?

RANK	BRAND	2004 BRAND VALUE (BILLIONS)	2003 BRAND VALUE (BILLIONS)	PERCENT CHANGE
53	KODAK	$5.23	$7.83	-33%
46	NINTENDO	6.48	8.19	-21%
8	NOKIA	24.04	29.44	-18
82	AOL	3.25	3.96	-18
19	FORD	14.47	17.07	-15

Data: Interbrand Corp., J.P. Chase & Co., Citigroup, Morgan Stanley

BusinessWeek online For an interview with Bezos and a Video View with Interbrand's Lindemann, go to businessweek.com/magazine/extra.htm

The 100 Top Brands

Here's how we calculate the power in a name

LOTS OF INGREDIENTS go into ranking the world's most valuable brands. To even qualify for the list, each brand must have a value greater than $1 billion, derive about a third of its earnings outside its home country, and have publicly available marketing and financial data. One or more of those criteria eliminate such heavyweights as Visa, Wal-Mart, Mars, and CNN. We don't rank parent companies, which explains why Procter & Gamble doesn't show up. And airlines are not ranked because it's too hard to separate their brand's impact on sales from factors such as routes and schedules.

***BUSINESSWEEK* CHOSE** Interbrand Corp.'s methodology because it evaluates brands much the way analysts value other assets: on the basis of how much they're likely to earn in the future. Then the projected profits are discounted to a present value, based on the likelihood that those earnings will actually materialize.

THE FIRST STEP IS figuring out what percentage of a company's revenues can be credited to a brand. (The brand may be almost the entire company, as with McDonald's Corp., or just a portion, as it is for Marlboro.) Based on reports from analysts at J.P. Morgan Chase, Citigroup, and Morgan Stanley, Interbrand projects five years of earnings and sales for the brand. It then deducts operating costs, taxes, and a charge for the capital employed to a at the intangible earnings. The company s out intangibles such as patents and custor convenience to assess what portion of tho earnings is due to the brand.

FINALLY, THE BRAND'S strength is asse to determine the risk profile of those earnir forecasts. Considerations include market leadership, stability, and global reach—its ability to cross both geographical and cultu borders. That generates a discount rate, w is applied to brand earnings to get a net pre value. *BusinessWeek* and Interbrand believ figure comes closest to representing a bra true economic worth.

RANK 2004	/ 2003		2004 BRAND VALUE $MILLIONS	2003 BRAND VALUE $MILLIONS	PERCENT CHANGE	COUNTRY OF OWNERSHIP	DESCRIPTION
1	1	COCA-COLA	67,394	70,453	-4%	U.S.	Little innovation beyond its flagship brand and poor management h caught up with Coke as consumers' thirst for cola has diminished.
2	2	MICROSOFT	61,372	65,174	-6%	U.S.	Its logo pops up on 400 million computer screens worldwide. But virus plagues and rival Linux took some luster off Gates & Co.
3	3	IBM	53,791	51,767	4%	U.S.	A leader in defining e-business, with services making up more than half of Big Blue's sales.
4	4	GE	44,111	42,340	4%	U.S.	With acquisitions in areas from bioscience to bomb detection, it's easier to buy GE's new theme of "imagination at work."
5	5	INTEL	33,499	31,112	8%	U.S.	No longer just inside PCs, Intel is using its muscle to set the agend for everything from wireless standards to the digital home.
6	7	DISNEY	27,113	28,036	-3%	U.S.	Long the gold seal in family entertainment, but newcomers like Nickelodeon and Pixar are siphoning off some of its brand equity.
7	8	McDONALD'S	25,001	24,699	1%	U.S.	Big Mac has pulled out of a two-year slump but still has to battle its reputation for supersizing the world's kids.
8	6	NOKIA	24,041	29,440	-18%	Finland	Tough times for the mobile-phone giant as its market share has slipped and younger buyers turn to rivals such as Samsung.
9	11	TOYOTA	22,673	20,784	9%	Japan	With rock-solid quality and the edge in hybrid cars, the Japanese au maker is on track to overtake Ford in worldwide sales.
10	9	MARLBORO	22,128	22,183	0%	U.S.	The No. 1 name in cigarettes has cut prices and upped marketing to beat back the challenges of higher taxes and fewer smokers.
11	10	MERCEDES	21,331	21,371	0%	Germany	With wobbly profits and quality problems, the luxury car brand is struggling to retain premium status.
12	12	HEWLETT-PACKARD	20,978	19,860	6%	U.S.	Covering everything from digital cameras to service, the IT giant wants to dominate the middle ground between Dell and IBM.
13	13	CITIBANK	19,971	18,571	8%	U.S.	New CEO Charles Prince has spurred on global expansion and boosted the consumer credit division.
14	15	AMERICAN EXPRESS	17,683	16,833	5%	U.S.	A recent federal court ruling that allows banks to issue Amex cards should give the brand another boost.
15	16	GILLETTE	16,723	15,978	5%	U.S.	Despite the tougher competition from Schick, the King of Blades stil reigns with new products like the battery-powered M3Power.

/ 2003		2004 BRAND VALUE $MILLIONS	2003 BRAND VALUE $MILLIONS	PERCENT CHANGE	COUNTRY OF OWNERSHIP	DESCRIPTION
17	**CISCO**	15,948	15,789	1%	U.S.	The networking behemoth used slick TV ads and key acquisitions like Linksys to extend its reach.
19	**BMW**	15,886	15,106	5%	Germany	The Bavarian auto maker is powering higher sales with a raft of new models from the sleek 6 Series sports coupe to the X3 baby SUV.
18	**HONDA**	14,874	15,625	–5%	Japan	Overtaken by Nissan at home and falling further behind rival Toyota in the U.S. market.
14	**FORD**	14,475	17,066	–15%	U.S.	Ford is trying to make quality "Job One" again after an embarrassing run of glitches, but leery consumers haven't yet regained trust.
20	**SONY**	12,759	13,153	–3%	Japan	It was late to the LCD TV boom, and the PS2 video game console is slipping. Worse, rival Samsung is in Sony's face.
25	**SAMSUNG**	12,553	10,846	16%	S. Korea	No longer known just for undercutting the prices of big Japanese brands, the Korean consumer-electronics dynamo is suddenly cool.
23	**PEPSI**	12,066	11,777	2%	U.S.	Targeted marketing and ads abroad with stars like soccer icon David Beckham have enabled the No. 2 cola maker to steal some of Coke's fizz.
21	**NESCAFE**	11,892	12,336	–4%	Switzerland	It's still the world's favorite instant coffee but even products like Ice Java struggle against hip upscale brands like Starbucks.
22	**BUDWEISER**	11,846	11,894	0%	U.S.	The growing global low-carb trend has left Bud flat. Plus, it's under attack from bulked-up and feisty rival Miller.
29	**DELL**	11,500	10,367	11%	U.S.	With its reputation for low prices and fast delivery, Dell continues to leave competitors in the dust.
27	**MERRILL LYNCH**	11,499	10,521	9%	U.S.	A painful overhaul is behind it. Now the retail brokerage is back in hiring and expansion mode.
26	**MORGAN STANLEY**	11,498	10,691	8%	U.S.	The investment bank's reputation is rising along with mergers and stock issuances, its specialty.
24	**ORACLE**	10,935	11,263	–3%	U.S.	The database-software business is up, but CEO Lawrence Ellison's fight to buy rival PeopleSoft makes Oracle look like a corporate raider.
28	**PFIZER**	10,635	10,455	2%	U.S.	The pharma industry's powerhouse, with 11 products each expected to top $1 billion in annual sales this year
31	**J.P. MORGAN**	9,782	9,120	7%	U.S.	The marquee investment bank had a solid year, and now can extend its reach with its $58 billion acquisition of Bank One Corp.
33	**NIKE**	9,260	8,167	13%	U.S.	With allegations of sweatshop operations behind it and a growing soccer line, Nike rules the athletic market.
30	**MERCK**	8,811	9,407	–6%	U.S.	The drugmaker has tried to bolster its lineup with more partnerships, but patent expirations and research flops still pinch.
37	**HSBC**	8,671	7,565	15%	Britain	After snapping up Household International in 2003, the "world's local bank" is making inroads in the U.S. market.
35	**SAP**	8,323	7,714	8%	Germany	Its establishment image and sharp marketing have helped SAP thrive in a volatile software market.
39	**CANON**	8,055	7,192	12%	Japan	Hot digital cameras and printers boosted sales. Next up: an expanded line of sleek color copiers.
38	**KELLOGG'S**	8,029	7,438	8%	U.S.	Jumping on the low-carb bandwagon has kept Kellogg's cereal business crackling.
41	**GOLDMAN SACHS**	7,954	7,039	13%	U.S.	With record profits, it remains one of the most prestigious institutions on Wall Street.
36	**GAP**	7,873	7,688	2%	U.S.	The retail chain has revived its brand with fresh fashions and celebrity endorsements.
NEW	**SIEMENS**	7,470	New	New	Germany	The Munich conglomerate behind everything from phones to power plants is seeing a payoff from years of global image building.
43	**IKEA**	7,182	6,918	4%	Sweden	The Swedish home furnishing chain is now pushing cheap chic furnishings as far as Russia and Asia.
44	**HARLEY-DAVIDSON**	7,057	6,775	4%	U.S.	The motorcycle icon has lowered seat heights to woo women and trimmed prices, but production limits put a brake on growth.
40	**HEINZ**	7,026	7,097	–1%	U.S.	Despite wacky colors and cute ads, it's proving hard to boost value in foods like ketchup and beans.
50	**APPLE**	6,871	5,554	24%	U.S.	The iPod digital music player gave one of tech's coolest brands the consumer electronics hit of the year.
45	**LOUIS VUITTON**	6,602	6,708	–2%	France	It has a hot Murakami line and Jennifer Lopez in its ads, but is Vuitton getting over-exposed?

THE GLOBAL BRAND SCOREBOARD

RANK 2004	2003		2004 BRAND VALUE $MILLIONS	2003 BRAND VALUE $MILLIONS	PERCENT CHANGE	COUNTRY OF OWNERSHIP	DESCRIPTION
45	NEW	UBS	6,526	New	New	Switzerland	With a consolidated brand and its catchy "You and Us" campaign world's biggest asset manager is booming.
46	32	NINTENDO	6,479	8,190	-21%	Japan	It has an unrelenting focus on kids, but has Nintendo abandoned gamers who have grown up?
47	46	MTV	6,456	6,278	3%	U.S.	The music network pumps cash for parent Viacom, and has an in national reach that's the envy of U.S. media rivals.
48	42	VOLKSWAGEN	6,410	6,938	-8%	Germany	Aging models and missteps make consumers write off the people car as pricey and a bit dull.
49	47	L'OREAL	5,902	5,600	5%	France	Expansion in Asia and smart targeting of ethnic markets have the personal-care group looking prettier every day.
50	52	ACCENTURE	5,772	5,301	9%	U.S.	The tech services giant has its mojo back, with a contract to secu U.S. borders, and more consulting work.
51	48	XEROX	5,696	5,578	2%	U.S.	The copier maker is starting to convince customers that it can be digital document one-stop-shop.
52	55	WRIGLEY'S	5,424	5,057	7%	U.S.	Sales are up as the gum maker looks to push popular brands int more mouths worldwide.
53	34	KODAK	5,231	7,826	-33%	U.S.	Removed from the Dow and only dominant in a film business that shrinks every year.
54	49	KFC	5,118	5,576	-8%	U.S.	Despite efforts to make the brand seem healthier, the world still focuses on the middle name in Kentucky Fried Chicken.
55	51	PIZZA HUT	5,050	5,312	-5%	U.S.	The low-carb craze crimped pizza sales, and the chain's tardiness diversifying its menu didn't help.
56	56	COLGATE	4,929	4,686	5%	U.S.	With a growing lead over Crest in markets from Russia to China, t toothpaste company is smiling.
57	54	KLEENEX	4,881	5,057	-3%	U.S.	The big name in tissues can't blow off fierce price-cutting by rivals higher costs in pulp and paper.
58	57	AVON	4,849	4,631	5%	U.S.	The cosmetic company's door-to-door model is performing beaut in foreign markets like Brazil and China.
59	53	GUCCI	4,715	5,100	-8%	Italy	Sales were slipping even before influential creative director Tom F said an April *arrivederci*.
60	NEW	EBAY	4,700	New	New	U.S.	With everything from vintage jewelry to new DVDs, it's where the world shops for bargains.
61	65	YAHOO!	4,545	3,895	17%	Switzerland	The Internet portal has found riches in sponsored search but form partner Google is muscling into its turf.
62	60	NESTLE	4,529	4,460	2%	France	Chocolate is the key ingredient, but the Swiss giant is moving into nutritional supplements and fitness bars.
63	62	DANONE	4,488	4,237	6%	France	Strong sales of dairy products and bottled water keeps the French food company in good health.
64	61	CHANEL	4,416	4,315	2%	U.S.	Successful couture and Nicole Kidman ads have kept this fashion house on people's lips, hips, and wrists.
65	59	PHILIPS	4,378	4,464	-2%	Netherlands	The Dutch electronics giant has scored some hits, but it's still struggling to fend off Asian rivals
66	74	AMAZON.COM	4,156	3,403	22%	U.S.	It dumped TV ads to cut prices, jump-starting sales and building it position as the Wal-Mart of the Web.
67	63	KRAFT	4,112	4,171	-1%	U.S.	There's new low-carbs packaging but critics accuse the food giant producing products that make kids fat.
68	75	CATERPILLAR	3,801	3,363	13%	U.S.	The equipment manufacturer is plowing ahead as the industrial se strengthens.
69	67	ADIDAS	3,740	3,679	2%	Germany	The German maker of athletic wear dominates in soccer, but is still trying to find its footing in the U.S.
70	68	ROLEX	3,720	3,673	1%	Switzerland	For high-end consumers, the leading luxury watch maker's appeal timeless.
71	76	REUTERS	3,691	3,300	12%	Britain	American CEO Tom Glocer's cost cuts and new products are helpin the info giant turn the corner.
72	69	BP	3,662	3,582	2%	Britain	Now second only to ExxonMobil in size, BP is raking in cash thanks high oil and gas prices.
73	66	TIME	3,651	3,784	-4%	U.S.	Softer advertising pulls down the brand even as its book division pumps out bestsellers.

RANK	2003	BRAND	2004 BRAND VALUE $MILLIONS	2003 BRAND VALUE $MILLIONS	PERCENT CHANGE	COUNTRY OF OWNERSHIP	DESCRIPTION
4	NEW	PORSCHE	3,646	New	New	Germany	The high-end Cayenne SUV produced record profits and turbocharged the brand.
5	70	TIFFANY	3,638	3,540	3%	U.S.	The lure of its diamonds, pearls, and silver is strong but Japan is looking tarnished and U.S. store sales are down.
6	81	MOTOROLA	3,483	3,103	12%	U.S.	Motorola is relevant again, with its clam-shell phones gaining in Europe and in new markets like China.
7	79	PANASONIC	3,480	3,257	7%	Japan	It boasts some of the best technology in must-have items like recordable DVDs and plasma-screen TVs.
8	78	HERTZ	3,411	3,288	4%	U.S.	Healthy international markets help the king of car rental roar again, even amid rising gas prices.
9	73	HERMES	3,376	3,416	-1%	France	The maker of silk scarves and Kelly handbags hopes designer Jean Paul Gaultier can freshen its image.
0	71	DURACELL	3,362	3,438	-2%	U.S.	Relentless discounting and promotions continue to commoditize the world of batteries.
1	NEW	AUDI	3,288	New	New	Germany	The new A8 and strong global expansion have made Audi a profit engine. It's even thriving in China.
2	64	AOL	3,248	3,961	-18%	U.S.	Federal accounting inquiries and a messy merger have tarnished the AOL name as it fights to keep customers.
3	82	HENNESSY	3,084	2,996	3%	France	Parent LVMH is toasting the popularity of cognac with the world's young urbanites, especially among the hip-hop set.
4	83	SHELL	2,985	2,983	0%	Brit./Neth.	The energy giant is struggling to recuperate from a reserves downgrade and a boardroom bloodbath.
5	77	LEVI'S	2,979	3,298	-10%	U.S.	Even its iconic 501 jeans are discounted these days and brands like Diesel are finding legs with young shoppers.
6	85	SMIRNOFF	2,975	2,806	6%	Britain	The best-selling vodka builds on its popularity with Smirnoff Twist and "malternatives" such as Smirnoff Ice.
7	86	JOHNSON & JOHNSON	2,952	2,706	9%	U.S.	Holding firm in a tough market, it had a hit with a drug-coated stent. But competition looms there, too.
8	NEW	ING	2,864	New	New	Netherlands	ING Direct and a forceful U.S. marketing push put the Dutch financial services firm on the map.
9	88	MOET & CHANDON	2,861	2,524	13%	France	Strong growth in Japan and the U.S. keeps the world's leading champagne brand bubbling along.
0	89	NISSAN	2,833	2,495	14%	Japan	Having pushed aside Honda in Japan, it's gaining North American share with Titan trucks and the Altima sedan.
1	NEW	CARTIER	2,749	New	New	France	The bejeweled panther has shed cheaper items and held tight to its luxury status through tough times.
2	NEW	ESTEE LAUDER	2,634	New	New	U.S.	This fixture of the high-end cosmetics counter is now expanding in middle markets like retailer Kohl's.
3	NEW	ARMANI	2,613	New	New	Italy	Known for classy clothes, it's expanding into everything from home furnishings to hotels and restaurants.
4	84	BOEING	2,576	2,864	-10%	U.S.	It has lost commercial market share to rival Airbus, as execs try to erase the taint of a Pentagon hiring scandal.
5	87	PRADA	2,568	2,535	1%	Italy	Still the preserve of pretty stars but rapid expansion and debt could dilute some of Prada's exclusive cachet.
6	91	MOBIL	2,492	2,407	4%	U.S.	It got a boost from reformulated motor oil and its status as NASCAR's official lubricant.
7	92	NIVEA	2,409	2,221	8%	Germany	The mid-market skin-care line is now a leader in plumping up men's faces, too.
8	93	STARBUCKS	2,400	2,136	12%	U.S.	Global expansion, new products, and yet more variations on the humble cup of java boost the coffee hut's appeal.
9	90	HEINEKEN	2,380	2,431	-2%	Netherlands	Sales may be flat at Europe's largest brewery, but the 141-year-old Amsterdam brand remains the world's favorite premium brew.
0	95	POLO RL	2,147	2,048	5%	U.S.	It has consolidated control of its clothing brand, pushing same-store sales up 11% in the last quarter of 2003.

e brand valuations draw upon publicly available information, which has not been independently investigated by Interbrand. Valuations do not represent a guarantee of future performance of the brands companies. **Data:** Interbrand Corp., J.P. Morgan Chase & Co., Citigroup, Morgan Stanley, *BusinessWeek*

SCHWAB As co-CEO and then chairman, he knows what wen wrong and why

COMMENTARY

BY LOUISE LEE

Restore the Core

Job One for Charles Schwab: Focus on "the Mass Affluent"

CHARLES R. "Chuck" Schwab always had a knack for bringing revolution to Wall Street. Today it's the brokerage with his name on the door that needs the shake-up. That was the clear message sent by the Charles Schwab Corp. board on July 20, when it ousted Chief Executive David S. Pottruck and asked Schwab to assume that role as well as his chairmanship.

Pottruck, who had been at the firm for 20 years, has said he was surprised by their action. He shouldn't have been. Truth be told, the firm lost its way after the great technology stock bust of 2000 and hasn't found it again. Share trading volumes—the lifeblood of any brokerage—tanked. And since then, almost of the company's efforts to diversify into new financial-serv areas to make up for lost trading commissions have been d appointing, whether they involved actively courting millio aires or trying to sell advice to ordinary investors. "Diversifi tion can cut both ways," says Joel K. Gomberg, an analyst William Blair & Co. "You can lose focus, and resources can allocated to businesses that aren't profitable enough."

Chuck Schwab, who turns 67 on July 29, needs to refocus t company quickly. That means identifying its true core bu nesses, focusing on them, and dumping excess baggage. It's r exactly an overnight task, but it's also not one that should ta months. After all, as co-CEO and then chairman, Schw worked with Pottruck, a 20-year veteran, and should know w key decisions were made and where they went awry.

The best chance for Schwab is to home in on its traditior key client group—the so-called mass affluent, those who ha investable assets of $100,000 to $1 million. There are millio

m around, and they're the main target of a slew of banks rokers. But Schwab has a big advantage over its competi- ecause it has served those clients well in the past and still illions of their accounts on its books. To keep them, it zero in on meeting their needs.

times, the firm has seemed to take its eyes off that ball. it began to race after rich clients with the acquisition of -shoe wealth manager U.S. Trust, for $3.2 billion in Meantime, discount brokers such as E*Trade Financial and Ameritrade Inc. started chipping at its client base cheap trades as low as a third of what Schwab was ing.

n before Chuck Schwab moved back into the hot seat, the egan offering cheaper deals to frequent traders and cus- s with more than $100,000 invested. That's an important ep for the firm in getting back its mojo. To keep the mass nt loyal—and paying more—Schwab needs to deliver r-caliber service than the discounters. That means strik- liances with other firms to make available a broader range ducts to its clients, such as the initial public offerings un- itten by Goldman, Sachs & Co. that it sells.

he other end of the spectrum, Schwab needs to work out to do with U.S. Trust. Since the get-go it has brought little adaches. Flaws in the company's technology led to viola- of money-laundering rules and ultimately a $10 million tarnishing Schwab's long-standing reputation for probi- e firm ended up sidelining U.S. Trust's top two executives. icture isn't much rosier today. U.S. Trust is overshadowed nty of other wealth-management firms. And last year, U.S. 's revenue fell 4%, to $628 million, the biggest drop g the company's units.

simplest course might be to sell. Banks such as Northern Corp. and Wilmington Trust Corp. that are building up businesses catering to rich clients might be interested in g. Alternatively, if Chuck Schwab decides to hold on, he lmost certainly have to keep it entirely separate from ab itself. Past efforts to meld the two cultures failed ally. One example: When Schwab tried early on to per- U.S. Trust to share its proprietary research with ab's customers, snooty execs simply refused.

ckstabbing Its Partners

HER PROBLEM the firm must address is its relationship he thousands of independent advisers who use Schwab as k office and park their clients' money there. Starting its dvice services alienated some of those advisers, who saw ab as treading on their territory. Some also balk at a few of es Schwab charges them for back-office services. At one , the company was sending these advisers' clients mar- g materials promoting Schwab's own advisory services. So

Pottruck has said his removal surprised him. It shouldn't have

fence-mending is clearly on Chuck Schwab's to-do list.

Returning to the firm's roots may also require exiting newly acquired sales-and-trading businesses. Schwab already appears to be shopping around its SoundView Capital Markets business, a trading-and-research outfit. The company paid $321 million for a part of this business in January. That's a good move because its returns have been skimpy. Selling Capital Markets would also underline Schwab's renewed commitment to retail customers. A Schwab spokesman declined to comment.

All this should improve Schwab's numbers. The same day Pottruck was pushed out the door, the company reported second-quarter income of $113 million, down 10% from a year earlier, though revenue rose 9%, to $1.11 billion. To goose earnings, Schwab is embarking on another round of needed cost-cutting and layoffs. The company's costs have long been high compared with other brokers that don't maintain such large branch networks. Analyst Matthew Snowling at Friedman, Billings, Ramsey Group Inc. says the firm is "just too bloated to be competitive."

Will Chuck Schwab fix up his brokerage just for a sale? Most analysts and investment bankers think not—at least not anytime soon. After all, he owns about 19% of the firm and has repeatedly said it is "well-positioned on its own." Besides, though Schwab's stock price is low, it's still pretty expensive and carries a relatively rich price-earnings ratio. Of course, there's a good deal of cleaning up to be done before he could attract decent offers in any case.

Certainly, many on Wall Street think Chuck Schwab has a good chance of turning his firm around. "Chuck's coming back signals that they're going to start refocusing on what made them successful in the first place, which is going after the mass market," says Snowling. And perhaps he will add a dash of that old revolutionary fervor that served him and his firm so well in the past. ■

–With Emily Thornton in New York and Justin Hibbard in San Mateo, Calif.

OW TO GET SCHWAB BACK ON TRACK

ncentrate on its basic businesses and dump the rest

OBLEM	**Retail brokerage's menu of advice services is confusing, and fees are high**	**U.S. Trust's rarefied culture clashes with Schwab's**	**Schwab SoundView Capital Markets, which serves institutional clients, is outside its core expertise**	**Relations with independent advisers have been tense since Schwab encroached on their business**
UTION	Focus on affluent middle-class clients, simplify services, and reduce fees	Run it as a standalone operation, downplaying Schwab link, or sell it	Sell it	Placate them by staying away from their clients

Data: BusinessWeek

How to Drive Suitors Wild

These days, just filing for an IPO can draw bidders and hike a company's price

GOING PUBLIC ISN'T what it used to be. The Sarbanes-Oxley Act of 2002 makes the process more expensive and time-consuming. Insiders can't unload stock after the offering without attracting intense scrutiny. And Wall Street analysts aren't as cuddly with chief executives as they once were. So, with all the hassles, do some of the companies filing to launch initial public offerings these days have ulterior motives?

Increasingly, private companies are pursuing an IPO and an outright sale at the same time. This parallel-track approach is gaining popularity as going public gets tougher and the market for acquisitions strengthens. While no company will admit that it filed to go public merely as a ploy to get a better price in a private sale, some execs concede that their IPO filing helped them attract a suitor and do just that. In the first six months of this year, eight companies that registered to go public were bought privately instead, up from two in the first half of last year, according to Thomson Financial.

The pace seems to be picking up. In June alone, three companies were snatched out of the IPO pipeline: Time Warner's America Online unit said it will buy Advertising.com for $435 million, restaurant chain Bob Evans Farms scooped up Mimi's Café for $182 million, and business-development firm Allied Capital announced it will purchase equipment-lease provider Financial Pacific for $94 million. What's more, at least three companies that were planning to file for IPOs this year were claimed by buyers first: online shopping service Kelkoo, wireless content-provider Jamba!, and telecom-equipment maker Telica.

The climate has certainly changed from the late '90s. Back then, if a company had a prayer of going public, it almost never sold out. "[That] was much less attractive then because you were going public at such high [price-earnings] multiples," says Raymond J. Lane, a partner at Menlo Park, Calif., venture-capital firm Kleiner Perkins Caufield & Byers. Traditionally, bankers have appraised a company for sale at 20% to 50% less than its IPO value because shares can be sold much more easily than entire companies.

But now, as some companies us tential IPO as a bargaining chip in sition talks, that discount is disa ing. A big reason is that buyers companies looking to expand and i ment firms—are flush with cash a willing to spend it as the econom tors ahead. In July, buyout firm Management LP bought Borden C cal Inc. two months after its IPO fil $1.2 billion. At the same time, com that have sat on the sidelines merger market are rejoining the f May, former telecom high-flyer L Technologies Inc. said it will buy for $295 million in stock and opti the company's first acquisition in years. "What's notable about ma these recent deals is that these c nies are being acqui the full value they trade at after an IPO," Tor Braham, co-he tech mergers and ac tions banking at Deu Bank Securities.

That's making ac tion offers very tempti execs. A raft of comp recently have had t their IPO prices befor ing to market. So it's h turn down a generous offer when the alterna to rely on a whimsical market. And after an execs may not be able t all their shares for up t en years; some othe vestors may be locked two years. A seller might say, "I ca $450 million off the table in cash, or cross my fingers and hope the IPO well," says Tom Taulli, princip Bridgewater Capital, a Newport B Calif., investment bank.

Advertising.com decided not to its fingers, but "there's no doubt" the company's impending flotatio NASDAQ gave it leverage with AOL, Chairman and Chief Executive Sc Ferber. He says AOL came back n than three times after it first approa his company. "We said, 'That's fine we're still going public unless you a definitive offer.' We were marc down both paths simultaneously." says Advertising.com's IPO plans w call to action. "We realized that i wanted to do something, this was opportunity," says Jonathan F. M AOL's CEO. As AOL might say, "Y got leverage." ■

–By Justin Hibbard in San Mateo,

Bargaining Chip?

After registering to sell shares to the public, companies are increasingly agreeing to be bought out. Some recent examples:

COMPANY	PRICE (BILLIONS)	BUYER
Noveon	$1.8	Lubrizol
Borden Chemical	1.2	Apollo Management
Advertising.com	0.4	Time Warner
Brightmail	0.4	Symantec
Mimi's Café	0.2	Bob Evans Farms

Data: Companies

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COMMENTARY

BY MARCIA VICKERS

There's No 'Quiet Period' for Bigwigs

Before an IPO, institutions get road shows—while small investors get shut out

YOU MIGHT SAY IT WAS a Willy Loman moment for initial public offerings. The extroverted chairman of Salesforce.com Inc., a San Francisco software company, was a tad overfriendly to the press. So in early May, the Securities & Exchange Commission put the brakes on the company's IPO. The SEC charged that Salesforce had violated "quiet period" rules by cooperating with *The New York Times* for a fairly innocuous profile. The company finally went public in June, about a month later than had been scheduled originally. The SEC declined comment. But the hullabaloo thrust an old issue into new light.

Investors are realizing that something is inherently wrong with the way companies are brought to the public market. A lot has to do with the quiet period, typically the time from when a company files to go public until 40 days after an IPO, during which a company is not allowed to do or say anything that might be considered hyping its stock. But it turns out that the quiet period is often anything but. In fact, its main purpose seems to be to give fat-cat players an edge over ordinary investors. How? In the runup to their IPOs, companies stage road shows, where big investors get to hear and question company management and its bankers. Meanwhile, because of regulations affecting the quiet period, the company often refuses to talk to the press or address any questions average investors might have.

Information is often given to pros at road shows that average investors don't have a prayer of receiving. Says Jay R. Ritter, a finance professor at the University of Florida: "There's a sleight of hand. Companies can say certain things that they're not allowed to write down." For instance, they often discuss analysts' forecasts of their earnings with road-show audiences but don't publish them.

The SEC is looking into the IPO process, says an agency spokesman. In 1998 it crafted a broad proposal dubbed the "Aircraft Carrier" because of its complexity and size, that would, among many things, allow a company to communicate more with investors before an IPO than now. On July 10, Alan Beller, the SEC's director of corporate finance, said in a speech that the agency was looking into allowing companies to say more, especially if they put it in writing. But experts say the SEC has been been dragging its feet on the proposal. And the agency's recent actions over Salesforce.com point in the posite direction.

The rules governing IPOs say a company and its under ers may discuss publicly only what has already been disc in public filings. The limits date from 1933. Back then, there good reason for them: The stock market was like the Wild with stock manipulators running rampant. But experts sa Depression-era rules are confusing. What's more, in this a technology, where informa flows much more freely, they antiquated. These days, it's si to stage a Webcast or confer call to include investors o stripes. It would have been ha do that over, say, the telegr Also, today's financial pres more sophisticated and less li to push stocks.

The gag rule made sense back in 1933, when stock manipulators ran rampant

Securities lawyers say m companies and underwriters happy to keep ordinary inves out of road shows and to avoid press. "They don't want to ex themselves to investor lawsuit inadvertently mentioning so thing not in the prospectus o luding to future performance ends up not being met," says I N. Edwards, head of the secur practice at Cleveland law firm Donald Hopkins. Companies institutional investors also w the shows will be dumbed dow the public is allowed in.

To avoid that, Menlow and ers argue that ordinary invest although still not admitted to r shows, should be allowed to listen to them through Webcast conference calls. Experts also suggest that compliance offic and securities lawyers play a bigger role to help "steer" m agement in its presentation—especially in addressing poin questions from assertive bankers. That, however, could limit goods-getting. Or the quiet period could be dumped altoge er. "In Europe, there's no quiet period, and it doesn't seem to fect the IPO process negatively," says Ritter.

Failing that, the quiet period could be renamed to refl what it really is. Some suggestions: the "insider-advant period" or the "put-the-screws-to-the-small-investor perio Just a thought. ■

TED BY
AH R. SHAPIRO

NOVATIONS

C-free plastic d spider toxin muscle ills

oamed polystyrene ic is a mainstay material nking cups, packaging, building insulation. But 's growing concern about nvironmental impact of hemical that's commonly to puff up the foam—ane. This volatile organic pound (VOC) gradually pes from the plastic nto the air, where it ributes to the formation nog. Now a European ct led by Nova nicals' researchers in The erlands has developed a to use water instead of ane. Germany's Teubert chinenbau has built a ial machine to make -free polystyrene foam may hit the market in months.

Tarantulas are big, idating spiders. But under at hair lurks a unique nical factory that uces an unusual peptide eir venom. It's the only vn biological compound relieves so-called stretch-itive channels. These e structures are involved ch muscle-related ills as t attacks, incontinence, muscular dystrophy. y, the peptide, dubbed Tx4, can't be used in pills ause it would get digested nzymes before entering oloodstream. But a team at State University of New at Buffalo reports in the 8 issue of *Nature* that they e created a mirror-image, ght-handed, version of the tide. It escapes digestion ause the enzymes target the peptide's natural, left-ded form.

–Otis Port

OIL PATCH

SCRAPING MORE OIL FROM THE BOTTOM OF THE BARREL

WHILE CURRENT gas prices may cause some people to go into shock, others get inspired. Researchers at Genoil, a Canadian company, have developed and are starting to sell a new refining technology that increases the yield of usable barrels of oil by 25%. The extra oil comes from the previously unrefinable viscous bottom residue.

Genoil's Hydroconversion Upgrader, which pumps hydrogen into the oil, is "something that can work immediately" to help alleviate gas shortages, says Genoil Chairman and CEO David Lifschultz.

In addition to producing more oil, Genoil's technique removes sulfur from the crude oil, reducing the amount of pollution produced when the fuel is burned. Genoil is now retrofitting a refinery near Salt Lake City, which should be ready in 6 to 10 months.

SECURITY

THESE ID TAGS GET UNDER YOUR SKIN

WHAT DO LOST DOGS, mad cows, and the Mexican police have in common? They may all benefit from radio-frequency ID (RFID) tags made by VeriChip, a subsidiary of Applied Digital Solutions in Palm Beach, Fla. Mexican Attorney General Rafael Macedo de la Concha says he and 160 of his deputies had the rice-grain-size chips implanted under the skin of their arms. Only people with the chips can get past electromagnetic scanners at a new federal anti-crime information center in Mexico City.

Each month, says Applied Digital, such RFID chips help reunite 6,000 lost dogs and cats with their owners. The technology could also be used to keep tabs on all cattle that share feed, so their meat can be tracked if there's a renewed outbreak of mad cow disease. Chipping humans, it seems, is the inevitable next step. *–Geri Smith*

IMMUNOLOGY

A SARS VACCINE FROM SURVIVORS' CELLS

SCIENTISTS AT THE Institute for Research in Biomedicine in Bellinzona, Switzerland, are perfecting a technique to generate antibodies for vaccines against SARS. First, they remove antibody-making cells called memory B cells from the blood of a donor who has survived SARS. These are cloned and screened to see which make the best antibodies. They can then be mass-produced using standard biotech methods.

Such SARS antibodies may someday be injected into anyone at risk of infection. That will come in handy

"when you don't have time to wait around for the body to make antibodies," says Kanta Subbarao, senior investigator at the National Institute of Allergy & Infectious Diseases in Bethesda, Md., who worked on the study. Still, SARS remedies of this sort may be three years away, says Antonio Lanzavecchia, director of the Swiss institute. His team hopes to use the new technique against other diseases as well. *–Jordan Burke*

COMMENTARY

BY CATHERINE ARNST

Why Business Should Make AIDS Its Business

Multinationals are taking baby steps to control the disease in their workforce

BRITISH MINING conglomerate Anglo American PLC has extensive operations in Africa, and it knows the devastation caused by AIDS. It estimates that 30,000 of its 125,000 employees in South Africa are infected with HIV. That's not unexpected, given that at least 22% of South Africa's entire workforce is HIV positive. ¶ Anglo American isn't counting on the foot-dragging South African government to solve its problems, however. In the early 1990s, the company started its own AIDS treatment and prevention program for workers and their families. And in 2002, Anglo American began administering highly effective anti-retroviral drugs to its infected employees—medicines that are still rare in Africa. It expects to treat 3,000 people this year, up from 223 in 2003. In a report delivered to the International AIDS Conference held in Bangkok in July, the company said the treatment costs were "offset by the sharp decline in mortality—from 30% to 3.4% in the first year—and in absenteeism due to illness."

Anglo American is operating out of enlightened self-interest, and it is not alone. A handful of other multinationals have realized that the governments of many developing nations lack the resources or the will to mount effective AIDS programs. Nike, ChevronTexaco, BMW, Heineken, and Coca-Cola, among others, have concluded that they must take it upon themselves to control AIDS among their own employees in Asia and Africa, or profits and economic progress could be severely hampered.

Unfortunately, far more corporations are doing nothing. According to a report by the World Economic Forum, two-thirds of 1,620 companies operating in Africa expect AIDS to affect their profits over the next five years, but only 12% have an AIDS policy. A U.N. survey found that just 21 of 100 multinationals have AIDS programs.

Such apathy is self-defeating. If multinationals don brace aggressive anti-AIDS tactics, both their employe their customers in emerging markets will inevitably fall to the epidemic. The dimensions of the disaster are laid a new study by the U.N.-affiliated International Labor O zation (ILO), which estimates that, out of 38 million peo fected with HIV globally, at least 26 million are workers.

The economic toll of AIDS is already well demonstra sub-Saharan Africa. There, 7.7% of the workforce is in with HIV, according to the ILO, with rates in Swazilan Botswana as high as 38%. South Africa, the region's eco anchor, saw its economy lose $7 billion—roughly 2% gross domestic product—every year from 1992 to 2002 be of AIDS-related workforce deaths.

Asia could soon go the same route. In China and Indi infection rates are beginning to rise at the same pace s Africa 20 years ago. The ILO predicts that by the end decade, 6 million workers in India and an additional 1.8 lion in China will have been by AIDS. "HIV/AIDS is not human crisis. It is a threat t tainable global social and eco ic development," warns Jua mavia, ILO director-general.

They must take on a job that governments can't–or won't–do

Few governments are adequ addressing the crisis. The U.N dicts that global spending on by governments and nongo mental organizations (NGOs) total only half of the $12 b needed by 2005. Will compani spond to entreaties from AID ganizations to pick up the slac

It is not an easy sell. "The things most companies wa discuss in the workplace are and death," says Diana Ba until recently a senior lectur Harvard Business School, wh done extensive surveys on AI the workforce. When a com does start down that road, the no easy exit strategy. "You just hand out condoms or

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testing," says Barrett. "Once you offer testing, you have to provide anti-retrovirals, and that means you have to rethink your whole medical capability. You also have to guard against workplace stigma."

There are successful models out there, however. Two years ago, General Motors Corp. set up a pilot AIDS program in Thailand, where it has 2,500 employees, with an emphasis on prevention. All employees receive training about how to protect against the disease and avoid discrimination against infected co-workers. Condoms are regularly distributed—1,000 condoms attached to key chains with the Chevrolet logo were handed out during one Family Day alone in 2003. GM provides voluntary and free on-site testing and counseling and pays for treatment at local hospitals for employees with AIDS. The company next plans to expand the program to operations in India, Indonesia, and China.

28 Million and Counting...

Estimated cumulative death toll of workers from AIDS

	2005	2010	2015
	(IN MILLIONS)		
Worldwide	28	48.2	74.2
Sub-Saharan Africa	20	34	50
Asia	5.1	10	18.6

The cost of such an effort is far lower than might be expected. GM budgeted $50,000 over two years for Thailand and India, about $8 per year per employee. Still, plenty of companies hesitate to make even that small commitment. "We often get the comment that 'It's not our problem. We're not an NGO, we're a business,'" says Simon Graham, regional program coordinator of the Thailand Business Coalition on AIDS.

But it is their problem. Lafarge Group, a French building materials multinational, says AIDS is the leading cause of death for its 7,500 employees in Africa and a major industrial risk in terms of absenteeism, loss of skills, and reduced productivity. Other multinationals must be suffering the same losses—or soon will. NGOs and local clinics are eager to help companies develop AIDS programs. The alternative—doing nothing—is too terrible to consider. ■

–With Bruce Einhorn in Hong Kong

Can Delta Carry Song's Tune?

The faltering company may remake its along the lines of its low-cost subsidiar

ON THE STEAMY TARmac at gate D33 of Hartsfield-Jackson Atlanta International Airport sits what may be a model for the future of Delta Air Lines Inc.: a snazzy white-and-green Boeing 757 operated by its lower-cost subsidiary, Song. Baggage handler Michael J. Moriarty exults that sliding bins on Song's 757s make loading luggage fast and easy, helping him turn around Song flights in 50 minutes. At Delta, hand-loading the heavy bags into holds often pushes turn times to an hour and a half.

Onboard Song, four cheery flight attendants in lime-green Kate Spade outfits work the 199-seat plane, instead of five on Delta's 183-seat 757s. Their job is easier, too. Instead of two or three classes of service, all passengers on Song fly economy. And each one luxuriates in an all-leather seat fitted with a 24-channel TV and two extra inches of legroom. "I wish Delta would do this to all its airplanes," says Steve Hill, a flight dant on American Airlines Inc., w cently flew Song to New York.

Delta just might. Top managem the third-largest airline is prepa massive seats-to-skycaps overhaul Gerald Grinstein, 71, the former ch Western Airlines, plans to outline D future plans to employees and unio on July 28, and present that "strate view" to the board in late August. stein declined to comment on the entation, but he has already employees in a series of internal m that Delta will look radically dif within a year. Wrote Grinstein i such memo on July 1: "A business s gy is being developed that does no solely on labor cost-cutting, but inc operational restructuring and innov we'll need to survive and compete." wins deep wage cuts from his p which looks more and more likely can toss in a few of the tricks that helped low-cost carriers thrive, Delta yet have a fighting chance to save its

How a New Delta Might Shape U

Bankruptcy is a real possibility—a new plan doesn't go to the boa till the end of August—but a restructuring could look like this:

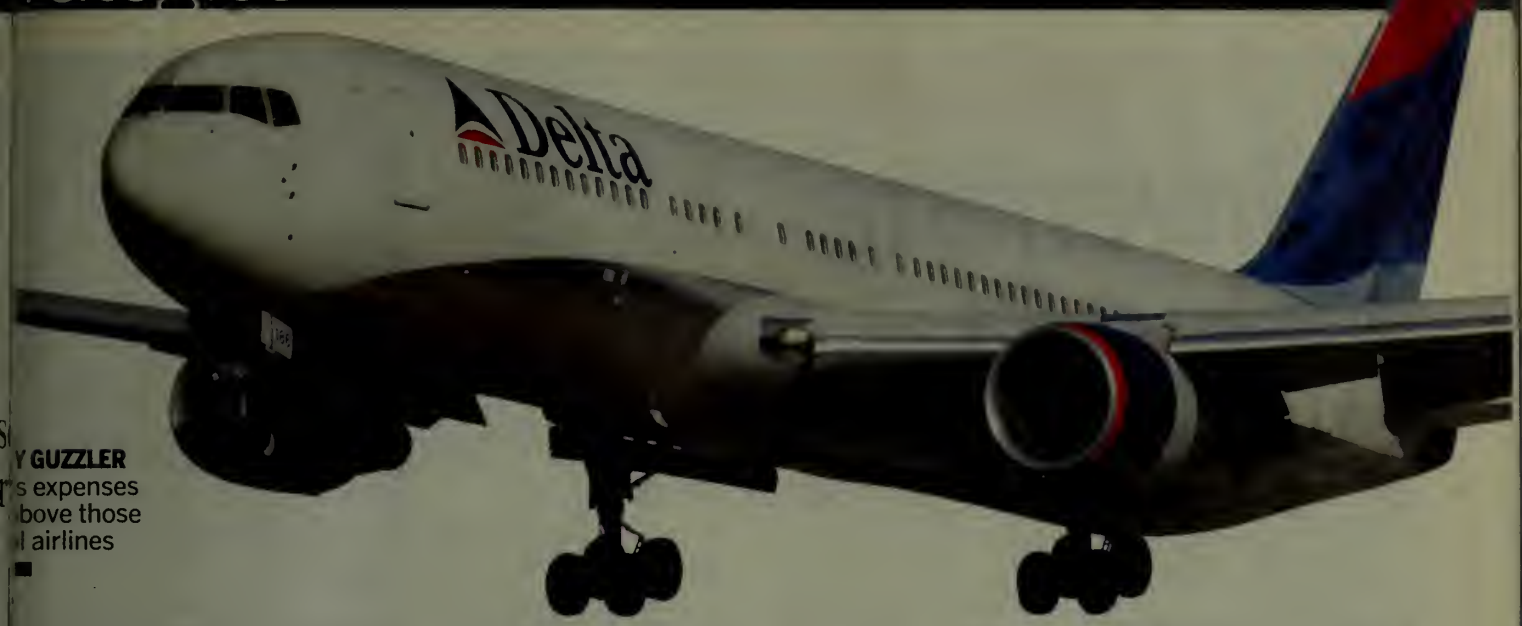
Data: Business Week, Delta Airlines Inc.

PILOT PEACE Delta gets a deal that cuts pilots' pay and benefits by about $900 million and requires more flying ho The pilots in turn receive an equity stake in the company.

LOWER COSTS To pare nonlabor costs, Delta ultimately runs more point-to-point flights, renegotiates jet leases, and scal back its costly Dallas hub.

MORE EFFICIENCY A larger number of all-economy flights, using bigger planes and fewer crew members.

PLANE FUN For more pizzazz, Delta adds seat-back TV and pay-per-view movies and sells such fare as organic foods.



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's expenses
bove those
l airlines

e situation at Delta is so dire that lit-
rt of an extreme makeover can keep
n Chapter 11. On July 19, the carrier
ed a $2 billion second-quarter loss,
y the result of $1.65 billion in non-
harges to write off deferred tax cred-
nd additional pilot pension costs.
than 300 Delta pilots called it quits
e. On an operating basis, Delta lost
million, vs. a $383 million loss in the
uarter. At the same time, its 2,090
lights have racked up $680 million
her fuel charges this year. Analysts
that Delta is depleting its $2 billion
restricted cash at a rate that could
it into bankruptcy by year's end. The
day the carrier reported its earnings,
s agency Standard & Poor's Inc.
graded Delta's debt to CCC+, or
ond status. "This is a last-gasp situ-
" says Robert J. Gordon, an airline
t and professor of economics at
western University.

SURE ON PILOTS

A PROBABLY NEEDS at least $2.1
n in annual savings to become com-
ve, say analysts. JetBlue Airways,
an Airways, and Southwest Airlines
same routes that provide Delta over
of its domestic revenue, and their
on average, are 27% lower. Delta
about $900 million in pay cuts and
ed medical benefits from its 7,500
, its only unionized employees. It
also try to restructure its pension
, to which it owes $3.7 billion—a
move that would cut retiree pay-
A further $100 million in savings
come from adding up to eight
per month to pilots' flying time.
e pilots union says changes in work
and pay cuts might be O. K. if linked
omplete restructuring. Analysts add
he pilots are also likely to seek equity in Delta and possibly a board seat. While the two sides publicly remain some $200 million apart, they have been quietly swapping proposals for weeks. On July 20, the pilots took a major step toward closing the gap, upping a previous offer of concessions worth about $300 million to as much as $705 million. "Bankruptcy is a bad place," says Richard M. Columbia, a 757 pilot and 25-year Delta veteran. Formal talks are slated to start on Aug. 3.

Things will be radically different in a year, says CEO Grinstein

An additional $1 billion in savings will have to be wrung out of nonlabor costs. Grinstein has said Delta could scale back its Dallas/Forth Worth hub, where it plays second fiddle to American. Delta may also end up paying less for the 348 planes it leases. "It will come as no surprise to aircraft lessors if Delta renegotiates," says Jonathan Rosenthal, a principal at investment bank Saybrook Capital LLC in Santa Monica, Calif., who is advising a group of Delta creditors.

Such moves might be enough to keep Delta in the air over the next year. But to meet the challenge of the low-cost carriers in the long term, Delta must bolster efficiency. "It's essential. They need the productivity," says David F. Ulmer, vice-president for planning at JetBlue. And that's where the new Delta is likely to look most like Song. Launched in April, 2003, Song's costs per available seat mile for its 36 Boeing 757s are about 20% lower than on Delta's 757s. (Overall, Delta had the second-highest costs in the industry last quarter, at 10.32¢ per seat mile, behind only US Airways Inc.) Song's efficiency has been achieved by avoiding expensive hubs, focusing on point-to-point flying with quick turnarounds, simple-fare flights, and the use of larger planes with smaller crews. Flying as many as seven flights daily on routes between Florida and New York, for instance, has made Song competitive with rivals such as JetBlue.

Analysts expect Delta to launch more flights similar to Song's New York-to-Florida runs on busy leisure routes from Florida or out of its small Salt Lake City hub. In fact, it's possible, say analysts, that Song will be folded wholesale into a Delta that appropriates its best practices. "[Song is] instrumental in the whole strategic review," says John Selvaggio, Song's CEO, who is on Delta's restructuring team.

Yet there is no way Delta can become a full-fledged low-cost carrier. On domestic routes with many business travelers, who are more apt to pay full fare, it is likely to stick with multiclass jets. To stay competitive with its low-cost rivals, it has to keep its big Atlanta and Cincinnati hubs. And Delta is loath to tinker with its lucrative international business. While passenger revenue fell 1.3% in North America in the second quarter, it rose 1.4% on transatlantic routes and 42% on flights to Asia.

Remaking Delta will be enormously difficult. Even some company veterans are doubtful that Grinstein can pull it off. "Delta doesn't change very easily," says Geri McManus, a 28-year Delta flight attendant who recently switched to Song. For now, hopes for a pilot pay cut and Grinstein's pledge to make "radical changes" seem to be all that's keeping Delta from singing its swan song. ■

–By Brian Grow in Atlanta

Reinventing Motorola

CEO Zander is shaking things up in a bid to make the company a tech leader

IT TAKES MOTOROLA INC. EMployees about 30 seconds after they meet Edward J. Zander to realize how different their new boss is from their last one. Where Zander's predecessor, Christopher B. Galvin, was reserved, polite, and genteel, Zander is a brash Brooklynite, incessantly pumping hands and flashing his trademark mile-wide smile.

But in March, three months after taking over the chief executive post, Zander showed he also was going to be much more demanding. He gathered his top 20 execs in the company's downtown Chicago offices, some 30 miles from the Schaumburg, Ill., headquarters, for a two-day brainstorming session on how to improve Motorola's lackluster execution. His message: Employees will be held accountable for customer satisfaction, product quality, and even collaboration among business units. "If you don't cooperate and work together, I will kill you," he said. Today, Zander laughs: "That's surviving-and-growing-up-in-Brooklyn talk. It was my way of saying, 'We're going to fix this thing.'"

Zander is about as affable as CEOs come, but he's deadly serious about restoring Motorola to the top of the communications world. The tech veteran, who spent 15 years at computer giant Sun Microsystems Inc. and eventually became its president, is trying to reinvent Motorola as a nimble, unified technology company. His most dramatic effort to date is a plan to dismantle Motorola's debilitating bureaucracy and end a culture of internecine rivalries so intense that Motorola's own employees have referred to its business units as "warring tribes." And he's not leaving it to chance: He has made cooperation a key factor in determining raises and bonuses. "It's a damn different place," says Patrick J. Canavan, a 24-year veteran and Motorola's director for global governance. "Everyone is looking out for everyone else."

The changes are just beginning. *BusinessWeek* has learned that Zander has been exploring a major reorganization, and the first steps of the restructuring may be unveiled at an investor conference in Chicago on July 27. By October, Zander hopes to abandon Motorola's stovepipe divisions, which are focused on products like mobile phones and broadband gear, and reorganize operations around customer markets—one for the digital home, for example, and another for corporate buyers.

One Zander target: Motorola's culture of internal competition

The reorganization will help Zander deliver on several new initiatives. Perhaps the most important is what the chief executive calls "seamless mobility." The idea is that Motorola should make it easy for consumers to transport any digital information—music, video, e-mail, phone calls—from the house to the car to the workplace. Mastering that technology would do more than boost cell-phone sales. It also could make Motorola a key player in the digital home, helping it sell flat-panel TVs and broadband modems, home wireless networks, and gateways to manage digital content. Separately, *BusinessWeek* has learned that Motorola is planning a major push to sell more services to corporations. While Motorola sells communications gear to corporate customers now, Zander sees an important growth opportunity in managing networks for those companies.

FAST START Under Zander, Motorola has posted two straight strong quarters

"We have to get more focused on
said Zander in an interview
BusinessWeek.

So far, Motorola is performing in
sively under its new chief executiv
July 20, the company reported that
ond-quarter sales surged 41%, to $8.
lion, while operating income rose five
to $845 million. The primary driver
the mobile-phone division, which bo
revenues 67%, to $3.9 billion. Stil
vestors are looking for Motorola to g
profitability up to the level of its rivals
spite Nokia Corp.'s recent troubles, th
erating margins in its mobile-phone
ness are 19%, compared with 10%
Motorola. "Margins are still sub-
says Barbara L. Rishel, a senior port
manager for MTB Investment Adviso
large Motorola shareholder.

HONING A CONCEPT

NO DISAGREEMENT from Zander.
though he's unlikely to announce it on
27, Zander is planning to trim cost
coming months by shedding emplo
according to insiders and analysts.
also plotting management changes
will bring in more handpicked peop
help execute his plans. On July 20,
torola said the head of its mobile-phon

New **Mission**

Zander is changing the cadence, focus, and even the shape of Motorola. Here are the key components of his plan:

NO EXCUSES: In the past, employee bonuses were based on the performance of their business units. Now, Zander has made collaborating across the company a key factor in raises and bonuses. And 25% of all bonuses are based on new metrics, including meeting product deadlines and getting high marks on customer satisfaction surveys.

SERIOUS BUSINESS: In the past, Motorola sold its phones to consumers and wireless gear to telecom companies. Now, Motorola wants to target the likes of Ford and UPS with communications gear and services, perhaps using partnerships with IBM and Accenture.

FRESH FORMATION: Zander thinks Motorola's structure of five autonomous business units isn't agile enough. He is considering a major overhaul—most likely, shifting to several groups that focus on types of customers, such as corporations and telecom companies. In the coming months he is expected to unveil the merging of two or more units.

INTERNET RULES: Zander wants Motorola to lead the way in combining wireless communications and the Net. He is pushing engineers to use Internet protocols so people can hand off home phone calls or digital music to a mobile phone as they leave the house. Motorola expects to hit the market with a product that can be a cordless phone at home and a cell phone on the road later this year.

ı, Tom Lynch, would leave the com- at the end of the summer. Zander de- l to discuss any details of cost-cutting ·cutive changes.

t investors that want Zander to jetti- oorly performing businesses may be pointed. The CEO proceeded with the ɔff of Motorola's semiconductor unit ıad been put in motion before he ar- —the deal took place on July 16, de- ıpheaval in the chips market. Still, in- ; say he's impressed with the ıning portfolio of businesses, includ- ıe $4.4 billion wireless infrastructure ess that some analysts have suggest- ıt Motorola dump.

stead, Zander is focused on reducing umber of separate businesses. Ana- ay he is working on a plan that could ine the wireless network unit with ɔmpany's broadband division. By col- ıg two units that make equipment to data through networks, Motorola cut expenses and smooth execution. er declined to comment on any po- l reorganization.

t as important as the structural es will be the strategy that goes with e concept of seamless mobility was on a flight to France in February, Zander and his chief technology officer, Padmasree Warrior, were headed to a wireless-industry conference. The strategy has been refined over the past few months until senior leaders from Motorola's business units gathered last month at Motorola University, adjacent to headquarters, to discuss strategies for internal development and potential acquisitions.

"YOU'RE SANDBAGGING"

THE MOTOROLA VISION starts with users sitting at home watching, say, the New York Yankees battling the Chicago White Sox. To leave home, they pause the video, transfer it to their phone, walk into the garage and transfer the video to the car as they drive away. The car would switch to audio so as not to distract the driver and then switch back to video if the driver stops at a traffic light. Motorola has the technology portfolio to pursue the entire scenario. Besides phones and cable set-top boxes, it has a $2.3 billion automotive-electronics business that develops technologies for cars to communicate with outside networks.

The key will be beating rivals to market with innovative solutions. That's why Zander's top priority has been improving execution. The main driver is a new incentive plan. In the past, workers were compensated based on the revenue, profit, and cash generated in their particular sector. If one sector did well, its employees pulled in huge bonuses. A unit that didn't perform got little or nothing.

Zander has been relentless in trying to get the most out of his staff. A new bonus plan bases 25% on three key areas: customer satisfaction, product reliability, and the cost of poor quality. When the heads of each business unit first laid out their targets, Zander's no-nonsense roots showed: "You're sandbagging," he barked. Before long, the targets were more difficult. "We're driving for improvement year over year," says Michael J. Fenger, a vet Zander picked to improve corporate quality.

If Zander can maintain Motorola's momentum, the years ahead look promising. It's gaining share on the world's mobile-phone leader, Nokia, and the elements of Zander's master plan have yet to take root. "It's a big ship," Zander concedes—so it will take time to change direction. But it takes no time at all to to see that Zander is committed to the challenge. ■

–By Roger O. Crockett in Chicago

BusinessWeek online For a Q&A with Motorola CEO Ed Zander, go to www.businessweek.com/magazine/extra.htm

Netflix: Moving Into Slo-Mo?

The rising cost of online ads blindsided the movie outfit. And rivals are looming

FOR NETFLIX INC., THE ONline movie-rental service, its second-quarter earnings report was as ugly as *Ishtar*'s debut. On July 15, the company reported net income that was lighter than Wall Street had expected. Worse, it said that marketing expenses were headed north because online advertising was getting pricier—this just months after Netflix assured investors those expenses wouldn't rise this year. In the next two trading days, the shares plunged 37%, to $20.17. [The marketing cost increase] was a risk that was out there and was denied by the company," says David A. Rocker, managing partner at Rocker Partners LP, which had a short position in the stock.

The biggest challenge is just arriving. Video-rental giant Blockbuster Inc. just unveiled a trial DVD-by-mail service that costs only $20 a month—a third less than analysts expected. If Blockbuster sticks with that figure, Netflix, which boosted its price from $20 to $22 in June, may have to roll back its increase. "That would have pretty broad implications," says analyst Jason Avilio of First Albany Capital Inc. CEO Reed Hastings vows to hold steady at $22, which Avilio estimates will mean net income of $70 million on $810 million in revenues next year. But the analyst ran estimates for the lower rate at *BusinessWeek*'s request. The result: Profits would fall to $38 million in 2005.

One week of bad news is hardly the end of Netflix. It's still by far the leading online DVD-rental service, with 2.1 million subscribers and 80% customer growth. The company still predicts it will reach 5 million subscribers by 2006. Amid the bad news, Netflix actually raised its 2004 net income target, to between $12.6 million and $22.1 million. "We're completely on track," says Hastings.

HASTINGS "From our perspective, we're completely on track," says the CEO

That's not all bravado. Analysts estimate that Netflix has five times as many DVD-by-mail subscribers as Wal-Mart Stores Inc. and an even greater lead on Blockbuster. Netflix has proprietary software that uses factors such as customers' past rentals to help subscribers find movies they like. About half its customers rate movies. And its 24 distribution centers let it ship to 80% of American addresses overnight by U.S. mail, compared with two or three days for rivals.

THE NETFLIX SHOW

Says analyst Derek Brown of Growth Equities: "Competition i fecting the company's ability to gr

Combine strong growth with w than-expected financials, and chan that Netflix will be acquired. Possib ers include online players such as zon.com, and telcos like Verizon Co nications. Amazon sells DVDs an Netflix, gets a competitive edge fro tomer ratings. Verizon, which is b cable-TV companies, could use Ne enter the video-on-demand bu Both companies declined comment

If Netflix doesn't get scoope video-on-demand looms as a long threat. Cable companies say film bu soon have little reason to trek to the store, or the ma "You can order a from your sofa and premeditated about you want," says Pugliese, vice-pre for marketing at Communications Consultant Pricew houseCoopers figur million U.S. house will use VOD in 20 from 6 million last y

Netflix is scram to position itself fo competition ahead. ings says the con will begin deliv movies over the Ne year. Still, Netflix fi it has time before v on-demand presents ous competition. "If flix isn't a major p when VOD arrives, we've screwed says Jay C. Hoag, a Netflix director.

To get the 5 million customers it ha geted for 2006, though, will take s execution—and maybe dramatic gest Piper Jaffray's Safa Rashtchy says I ings, who has been selling 10,000 sha week, should buy some Netflix stock t build credibility with investors. The who owned 5.7 million shares as of M declined the invitation. "I'm not tryi convince the market fast—I'm tryin build a big stable business," he Whether he can get there may depen rebuilding a foundation of trust the week has done a lot to shake. ■

–By Timothy J. Mullaney, Tom Lowry, in New

BusinessWeek online

For a Q&A with Hastings, go to businessweek.com/magazine/extra.htm

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ving what it takes to run a business: priceless)

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MAKING JEEP SEATS Workers at Johnso Controls' 10 factor have joined the UA

A Breakthrough For Labor

The UAW's membership gains in auto parts show a way to grow

BACK IN 1997, WHEN THE United Auto Workers (UAW) tried to sign up new members at car-seat maker Johnson Controls Inc. (JCI), it met a familiar all-out-war mentality. Security guards barred organizers from entering the parking lot at JCI's plant in Taylor, Mich. And when the union staged a rally outside the plant, management bused employees in from a remote lot to keep them from meeting union recruiters. Bosses even dropped hints that if workers joined the UAW, it could jeopardize the plant's future.

Today the UAW not only represents the employees at the Taylor factory and nine other JCI plants but it also has signed up tens of thousands more at the major U.S. auto-parts makers, including Collins & Aikman, Dana, Lear, and Metaldyne. The UAW's success—it signed up 17,000 parts workers last year alone—has enabled it to start reunionizing the parts industry after years of relentless membership losses that had occurred as the largely nonunion parts makers took over work outsourced by the Big Three auto makers.

The gains are modest so far: The union represents about 25% of the U.S. auto-parts industry's 570,000 workers, up from 23% in 1999 (though still way down from 56% in 1976). Still, it's an historic shift: Labor experts say no union has increased its representation of a basic U.S. industry since labor's share of the workforce began to slide half a century ago. "We were losing the industry," concedes Bob King, the UAW's vice-president for organizing. "But now our [share] is up, which is the first positive turn we've had."

The UAW's v holds important le for organized labo Corporate America more than a de union leaders and outside experts hav tended that labor's term decline stems much from workers of interest in unior rather from fierce op tion by manager The UAW's auto- success bolsters claim. That's bec signups haven't through traditional tions supervised b National Labor Relations Board (NI which usually involve nasty battle tween labor and management. Ins the union has leaned on Detroit car ers to persuade their parts suppliers main neutral when UAW recruiters knocking. Rather than resist unio tion, JCI and others have voluntarily ognized the UAW when a majority plant's workers sign union-recogn cards—a process known as card che

PENT-UP DEMAND

IF THE REST OF THE LABOR move could blunt employers' animosity an them to agree to neutrality and checks, millions of workers would l join labor's rolls, union officials argue deed, unions are fond of citing showing that about 42 million U.S. w ers—some 40% of the workforce— tinely say they would join a union if a were held at their work site. But once ployers counterattack to keep a union studies show, many workers change minds. As a result, unions have l mounting many fewer NLRB electi

After years of decline, A Reversal

UAW membership as a share of the American workforce

	1999	200
UAW Auto Parts	23%	25
U.S. Workforce	14	13

Data: United Auto Bureau of Labor St

yielded just 74,000 new members ar, according to the Bureau of Labor ics. Instead, they're turning increas- to card checks, which now bring in hing like 200,000 new members a or the communications, garment, her unions, the AFL-CIO estimates. or is pushing hard to win legisla- at would require companies to ac- ard checks. But those efforts are a hot, say analysts, even if likely De- tic nominee John Kerry wins the lency. Meanwhile, the Republican ty on the NLRB is moving to tight- rent card-check laws (sidebar).

YBODY WINS

UAW, OF COURSE, enjoys clout to nd card-check deals that most oth- ions don't because of its relation- vith Detroit. The card-check strate- s devised by King, who saw it as a o cope with the massive outsourc- y General Motors, Ford Motor, and lerChrysler. In the 1990s, the UAW ted local strikes to stop Detroit subcontracting parts jobs to most- nunion suppliers such as JCI. But ig Three figured they had little e, given the competition from nion Japanese carmakers and Mex- arts makers.

the UAW went to the auto makers a deal. The union would stop bat- if they would get parts suppliers to ighting union drives. The Big Three egally tell Dana Corp. or JCI what to t they have rewarded parts makers lay ball by outsourcing more work m. In recent years, large U.S. parts rs have agreed and signed card- pacts. "The Big Three told the 'We can't afford to do this work,'" Roger A. Jackson, a senior vice-pres- for 110,000-worker Lear Corp. the good news is we'll outsource o a UAW-friendly supplier.'"

e result: Many parts jobs offloaded e Big Three remain union, although now pay an average of $15.84 an vs. the $22 carmakers had paid to e work in-house. Auto makers are y to cut their costs, parts makers are o get more work, and many workers lieved their jobs didn't go overseas at they have union protections such evance procedures.

e UAW still has a long way to go be- t controls auto parts the way it does assembly. And there's still the large held by nonunion Japanese car- rs. But after decades of decline, the is showing new signs of life.

–By David Welch in Detroit

LABOR LAW

The Rush to Squash A Promising Union Tactic

Labor's growing use of card-check drives has kicked off a fierce political controversy. This spring, Democrats have introduced bills into Congress that would vastly expand the union organizing tactic. Several Republicans have snapped back with legislation to outlaw it. While nothing is likely to pass before the November elections, more immediate action could come out of a battle brewing inside the five-member National Labor Relations Board (NLRB), the judicial body that oversees federal labor law.

In an unusual step, the three Republicans on the board voted in mid-June to hear a challenge to card-check deals between the United Auto Workers (UAW) and two auto-parts makers, Dana Corp. and Metaldyne Corp. Over the objections of their two Democratic colleagues, the majority has decided to call into question the very concept of employers voluntarily recognizing a union without an NLRB-supervised election.

While the case wouldn't actually outlaw card checks, the majority made it clear that they have serious doubts about the idea. "The secret-ballot election remains the best method for determining whether employees desire union representation," they wrote in their June 7 order calling for briefs on the issue. Unions and companies submitted briefs on July 15, though there's no deadline for the board to rule. The NLRB declined to comment.

The cases involve workers at Dana and Metaldyne plants who demanded formal NLRB elections after the companies and the UAW had agreed to card checks in 2002 and 2003. The workers got support from the National Right to Work Legal Defense Foundation, a gadfly anti-union group that has been battling card-recognition deals around the country for several years. NLRB regional directors rejected their requests, saying card checks have been legal since the 1935 National Labor Relations Act laid out modern labor law. But the GOP board members overruled them, saying the rise of card signups warrants the extraordinary step of questioning long-standing precedent.

The majority, made up of Chairman Robert J. Battista, Peter C. Schaumber, and Ronald E. Meisburg, run the risk of appearing to inflame an already highly charged issue, union lawyers say. For one thing, the vote split along party lines, politicizing the case. More unusual, the majority insisted on hearing from all interested parties in six weeks—an uncharacteristic hurry for an agency whose cases often drag on for years. The Republicans even rejected a request for an extension by the board's own general counsel. Labor officials charge that they're rushing because Meisburg is a recess appointee whose term expires when Congress goes out of session for the November Presidential elections. If likely Democratic nominee Senator John Kerry (D-Mass.) wins, he would be able to appoint a Democrat and derail the GOP majority.

Either way, the case has split Corporate America. Dana, Metaldyne, and the Big Three auto makers all filed briefs supporting card checks, as did other unionized employers such as Liz Claiborne, Kaiser Foundation Health Plan, and Lear. Opposing briefs have come from business groups such as the U.S. Chamber of Commerce and the National Association of Manufacturers, which, oddly enough, counts most of the auto makers and their suppliers among its members.

–By Aaron Bernstein in Washington

Elections vs. Signups

VOTING Traditionally, most unions recruited through secret-ballot elections supervised by the National Labor Relations Board

CARD CHECK In recent years, unions have persuaded some employers to recognize them voluntarily when a majority of employees sign union-authorization cards—a process called card check

Data: BusinessWeek

KICKIN' Soccer coach McCrath, 68, was cane-free in eight days

New Knees, No Big Deal

Minimally invasive surgery uses smaller incisions, spares muscles and tendon requires less medication, and gets patients up and out fast. **BY MICHAEL ARND**

LIFF McCRATH'S KNEES were shot. After 44 years of coaching college soccer—and years of wearing cleats himself before that—the 68-year-old jokes that his legs had become so bowed, someone could have tossed a medicine ball between his knees and it wouldn't brush his pants. So, like hundreds of thousands of Americans every , McCrath had his knees replaced, in mid-February. ke most of the others, however, McCrath says he was "up at 'em and feeling great from the first day." He was back in four days and walking entirely ut crutches four days after that. To- no longer needs to sit as he coach- men's soccer team at Seattle Pacif- iversity, and for the first time in he works out on a treadmill.

difference? McCrath underwent test thing in joint replacement: nally invasive surgery. Borrowing such less traumatic procedures hroscopy and endoscopic abdomi- rgery, doctors are replacing knees hips through much smaller inci- They're also finding ways to avoid through muscles and tendons guided by computers, they're in- g artificial joints more accurately. result: less injury and pain and ier recoveries.

hough increasingly common and ssful, conventional knee-replace- surgery continues to be a dreaded tion. Following the standard proce- which starts with an incision up to hes long, patients often spend their ost-op day or two doped up in a hos- bed. Once they're out of bed, they a walker or crutches to move d and they remain hospitalized for a on average. Then it's two or three hs of physical therapy, pain medica- nd relying on a cane.

th minimally invasive surgery, the three-to-six inches long. Doctors through this smaller opening to re- the ends of the femur and tibia and e them with an artificial joint. Pa- often can bend their knees nearly at t angle later the same day and take the next day with only a cane. They three or four days in the hospital re walking without any assistance in weeks. "To me, there was nothing to ys Roy Gould, 62, a retired school- ontractor who had both knees re- last February and was home three ater.

e biggest challenge is finding an experienced practitioner. Only a fraction of the nation's 20,000 orthopedic surgeons perform the procedure, so just 20% of hip and knee replacements are minimally invasive, estimates Steven Hirsch, general manager of the reconstructive division of Smith & Nephew, an artificial joint maker.

SHRINKING SCALPELS

BUT MORE DOCTORS are learning the ropes. DePuy Orthopaedics, a subsidiary of Johnson & Johnson, is putting 75 surgeons a month through a two-day, hands-on course in the technique. Booked solid through the end of the year, DePuy may add a second session per month. Smith & Nephew and Zimmer Holdings, another artificial joint manufacturer, are training similar numbers of doctors in the new method. In three or four years, Hirsch predicts, this gentler form of joint replacement will become the standard. We may even start to see minimally invasive spinal operations.

ARTIFICIAL KNEE
Courses that teach the new procedure are booked solid

Medical-products companies have modified their implants and downsized their surgical tools to allow doctors to work through smaller wounds. DePuy has developed software that enables surgeons to look at a computer screen and "see" under a patient's skin, based on CAT scans of the bones taken before surgery and the position of two light-emitting diodes that are pinned to the leg.

Doctors are discovering new ways to minimize incisions, too. Like plastic surgeons, many orthopedic surgeons now stretch a patient's skin and adjust the joint during surgery to expose different areas underneath, eliminating the need for longer cuts. And many surgeons no longer slice through leg muscles, such as the quadriceps or tendons, as they remove bones and insert the implant. Instead, they make only a small cut along the grain of the muscle or spare the muscle altogether by working beneath it. That means faster recoveries and less pain.

Perhaps no doctors have embraced this approach as fully as Richard Berger and Aaron Rosenberg at Rush University Medical Center in Chicago. In 2002, the duo started replacing hips and knees as outpatient surgery. Operations are done around 7 a.m. and patients go home roughly 12 hours later. The doctors also do not use general anesthesia. Instead, patients are sedated with Valium and numbed from the waist down with a spinal painkiller. Some are even alert and talking during surgery. As a rule, surgeons require patients to be hospitalized for at least a couple of days in case of complications. But Berger and Rosenberg say they've done hundreds of joint replacements with same-day discharges and have never had a readmission.

Minimally invasive surgery is not an option for people who are grossly overweight, have joints that were badly damaged in an accident, or have already had major joint operations. Physicians say there are no added risks, and researchers are collecting data that show how beneficial the new technique can be for everyone else. Dr. Richard Laskin, a hip-and-knee replacement specialist at New York's Hospital for Special Surgery, says patients who have minimally invasive surgery take 35% to 40% less pain medication than those who have the standard operation, according to a study he recently oversaw.

Sue Centko, 51, a postmaster in Pana, Ill., is one such patient. She had arthroscopy on her knees twice and was on crutches for five weeks each time. Then she had minimally invasive knee replacements—and was walking without crutches or a cane two weeks after the second operation. Before, she was on pain pills. But now, even while lifting 70-pound packages at work, she needs no medication. "I saved a month's worth of pain and recuperation," she says. Who wouldn't jump at that? ■

(FAR LEFT) PHOTOGRAPH BY BRIAN SMALE

Keeping Fit In a Flat Market

The Mutual Fund Scoreboard points to funds for the long haul. **BY LAUREN YOUNG**

IT'S HARD TO DRAW A BE
the stock market these
With the major equity i
flat for the year, it feels li
ther the bulls nor the bear
charge. So where does tha
an investor in search of
good places to stash some cash?

Try *BusinessWeek*'s Mutual Fund
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annual roundup of funds every J
we update the list monthly at Bu
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mutual_fund/). Now, we're taking a
the funds that have risen to the top
past six months (table).

The scoreboard doesn't screen
hot fund of the day. It takes a lon
view, measuring funds by their fi
track records, adjusted for downsio
The funds receive an overall grade
to F. Equity funds are rated agains
equity funds, and taxable and tax-e
bond funds are also stacked up a
their counterparts. The Scoreboar
one step further, giving category r
that compare funds to their peers, s
large-cap growth or foreign stock f

All told, there are 188 equity
with overall A ratings, and 45 ar
since January. Thirty-one of the ne
ers come from two corners of the i
ment universe—real estate and sma
stocks. That's not surprising, b
those sectors did well in recent
Does that mean you should dump
the large-cap funds and replace
with real estate and small-compa
vestments? Absolutely not. And it d
mean you should sell real estat
small-cap funds, either. Both are
sectors to stick with for the long ha

New entries on the A-list are
careful consideration, especially if
also have an A rating in their cat
The ABN Amro Mid Cap Fund, up a
erage 14.8% a year over the pas
years, is a prime example. Portfolio
ager Thyra Zerhusen says mid-cap s
are often overlooked by large instit
al investors, such as pension funds.
tend to focus on large and small-com
stocks. "Rarely do they pick mi
managers," she says. Mid-cap name
get ignored by Wall Street analysts.

TIGHT FOCUS

AS A RESULT, there are plenty of u
covered winners among mid-caps, w
Zerhusen defines as companies with
ket capitalizations of $1 billion to $1
lion. Zerhusen runs the no-load fun
concentrated manner: She owns abo

anies, and the 10 largest holdings ac- for 40% of the assets. "These are the anies where I have the highest level fidence," she says. One example is a International, a Canadian auto- manufacturer. Magna's business is etween North America and Europe, 's benefiting from the outsourcing on both continents. Revenues are ng in excess of 20% annually.

hough they're better known, large- tocks are idling. Profits at many anies doubled over the past five but "the stocks have done noth- says Robert Smith, portfolio man- of the $6.5 billion T. Rowe Price th Stock Fund, which gets an A rat- the large-company growth catego- says investors are punishing large or failing to deliver the kind of earn- xpansion seen in the late 1990s.

Higher earnings on lower share prices means price-earnings ratios of large-company growth stocks are more reasonable. Smith foresees a rebound in blue chips such as Microsoft and General Electric. Another favorite is Citigroup, the fund's top holding, which has an array of global businesses, including credit cards and investment banking. By Smith's estimates, it's cheap, trading at 10 times 2005 earnings with a 13% growth rate. The recent $2.65 billion settlement with WorldCom shareholders hurt second-quarter earnings, yet Smith says the long-term outlook is bright.

Large-cap stocks are idling despite higher earnings

The Scoreboard is also a good place to find specialty funds, such as Fidelity Investments' Select Medical Equipment & Systems Portfolio, which has an A ranking in the health category. Portfolio manager Sam Peters says he's investing in neurostimulation, a therapy in which small electrical devices are used to treat ailments such as back pain. Medtronic, a top holding, is making progress in the field with new technologies.

Peters is also a fan of Baxter International. He sees the diversified medical-products company rebounding as the excess supply in the blood-plasma market starts to disappear. With demand for plasma expected to stay high, he expects better pricing power for Baxter's blood collection and processing systems.

Among other sectors, experts say real

ew A-Rated Funds

essWeek rates mutual funds based on their risk-adjusted returns over a five-year period. Funds get an overall rating (A to F) based on how they compare all other equity funds. The following have earned A ratings since we last published the list in January. Those that are also rated A in their categories are by the double asterisk (**). Additional funds with A category ratings are at BusinessWeek Online.

/Symbol	Category	Average Annual Total Return (%)*	Fund/Symbol	Category	Average Annual Total Return (%)*
AMRO Mid Cap N**/CHTTX	Mid-cap Blend	14.8	Morgan Stanley Instl. U.S. Real Estate A/MSUSX	Real Estate	13.6
AMRO Real Estate N/ARFCX	Real Estate	13.6	Munder Healthcare B/MFHBX	Health	17.0
nceBernstein Real Estate Invst. Adv./ARSYX	Real Estate	13.7	Munder Small-Cap Value Y/MCVYX	Small-cap Value	14.3
/ARGFX	Small-cap Value	13.1	One Group Small Cap Value I/PSOPX	Small-cap Value	15.2
vyn/BERWX	Small-cap Value	13.2	PBHG REIT Advisor/PBRAX	Real Estate	13.4
os Real Estate Securities Y/BJRSX	Real Estate	13.1	PIMCO RCM Global Healthcare D/DGHCX	Health	14.9
ham Financial Services A**/BURKX	Financial	25.5	Principal Real Estate Securities A/PRRAX	Real Estate	14.7
mbia Real Estate Equity Z/CREEX	Real Estate	13.2	Royce Pennsylvania Mutual Inv./PENNX	Small-cap Value	14.2
Vance Asian Small Companies A/EVASX	Diversified Pacific/Asia	19.1	Royce Premier/RYPRX	Small-cap Value	14.1
n Vance Wldwd. Health Sciences A/ETHSX	Health	17.4	Royce Total Return Inv./RYTRX	Small-cap Value	13.2
lsior Real Estate/UMREX	Real Estate	13.2	SAFECO Small-Cap Value Inv./SFSCX	Small-cap Value	14.8
ard Uniplan Real Estate Investment/FFREX	Real Estate	13.2	STI Classic Small Cap Value Equity L/STCEX	Small-cap Value	13.5
klin Biotechnology Discovery A/FBDIX	Health	15.1	Schroder Capital US Opportunities Inv./SCUIX	Small-cap Growth	13.5
elli Westwood Realty AAA/WESRX	Real Estate	13.7	Sentinel Small Company A/SAGWX	Small-cap Blend	14.9
man Sachs Growth Opportunities A**/GGOAX	Mid-cap Growth	14.4	Smith Barney Security & Growth A**/SAFEX	Domestic Hybrid	13.7
lman Sachs Real Estate Sec. A/GREAX	Real Estate	14.2	Smith Barney Small Cap Value A/SBVAX	Small-cap Value	14.2
is Insight Small Cap Value N/HSVAX	Small-cap Value	14.2	Stratton Small-Cap Value/STSCX	Small-cap Value	13.5
res MSCI Austria Index/EWO	Europe	14.4	T. Rowe Price Mid-Cap Value/TRMCX	Mid-cap Value	13.5
uropean Opportunities A**/IEOAX	Europe	20.9	TAMARACK Microcap Value S/TMVSX	Small-cap Value	14.3
nison Health Sciences B/PHLBX	Health	16.6	Third Avenue Small-Cap Value/TASCX	Small-cap Value	13.9
Abbett Small-Cap Value A/LRSCX	Small-cap Value	15.0	Vanguard REIT Index/VGSIX	Real Estate	13.9
nStay Small Cap Value B/MSPBX	Small-cap Value	13.7	Wells Fargo Small Cap Opportunities I/NVSOX	Small-cap Growth	13.8
Stanley Instl. Intl. Small Cap A**/MSISX	Foreign	13.1			

through June 30. Appreciation plus reinvestment of dividends and capital gains before taxes. **Data:** Standard & Poor's

estate funds still have room to run, although returns are not expected to be as robust as in recent years. "We believe real estate investment trusts are expensive," says David Jellison, portfolio manager of the A-rated $900 million Columbia Real Estate Equity Fund. Nevertheless, Jellison found opportunities in sectors of the real estate market that have lagged and offer good value. They include apartment owners such as Equity Residential and hotel operator Hilton Hotels.

What about small-company stocks? The pros say it is getting harder to find good ones. That's why the Third Avenue Small-Cap Value Fund has more than 25% of its $790 million portfolio in cash. "There's no question that the universe of opportunity is narrower than it once was," says portfolio manager Curtis Jensen.

Whitney George, who co-manages the Royce Pennsylvania Mutual Fund and the Royce Premier Fund—both of which are new additions to the overall A list—is also pessimistic. "We're in a very toug ronment and a low-return decad though Royce's record is stellar— its funds have an A rating—Georg vising people to look at secto haven't performed as well in recen From a value manager who make ing finding gems in what most in toss aside, that's solid advice. ■

BusinessWeek online For more tables Q&As with mutual-fund managers, go www.businessweek.com/magazine/ex

Health

Cholesterol Drugs: Not So Fast

Have high LDL? A CRP test may help your doctor decide if it poses a threat. **BY CAROL MARIE CROPPER**

MILLIONS OF HEART patients thought they had their cholesterol under control until a government-appointed panel of experts issued new guidelines in mid-July. Now people considered at risk of heart attack, whose "bad" LDL cholesterol is as low as 100 milligrams per deciliter, may be wondering whether they should start popping pills. Previously, doctors usually didn't steer patients to cholesterol-lowering statin drugs unless their low-density lipoprotein measured 130 or greater. But before you fill a prescription, you might want to take a simple blood test. Called the high sensitivity C-reactive protein test, or CRP, it can provide another clue as you decide whether drug therapy is right for you.

The test detects low levels of a protein that indicates systemic inflammation in the body. Scientists have found a link between such inflammation and the buildup of harmful plaque in blood vessels. A study of 28,000 women, published in the *New England Journal of*

Medicine in 2002, showed it to be a predictor of heart attacks.

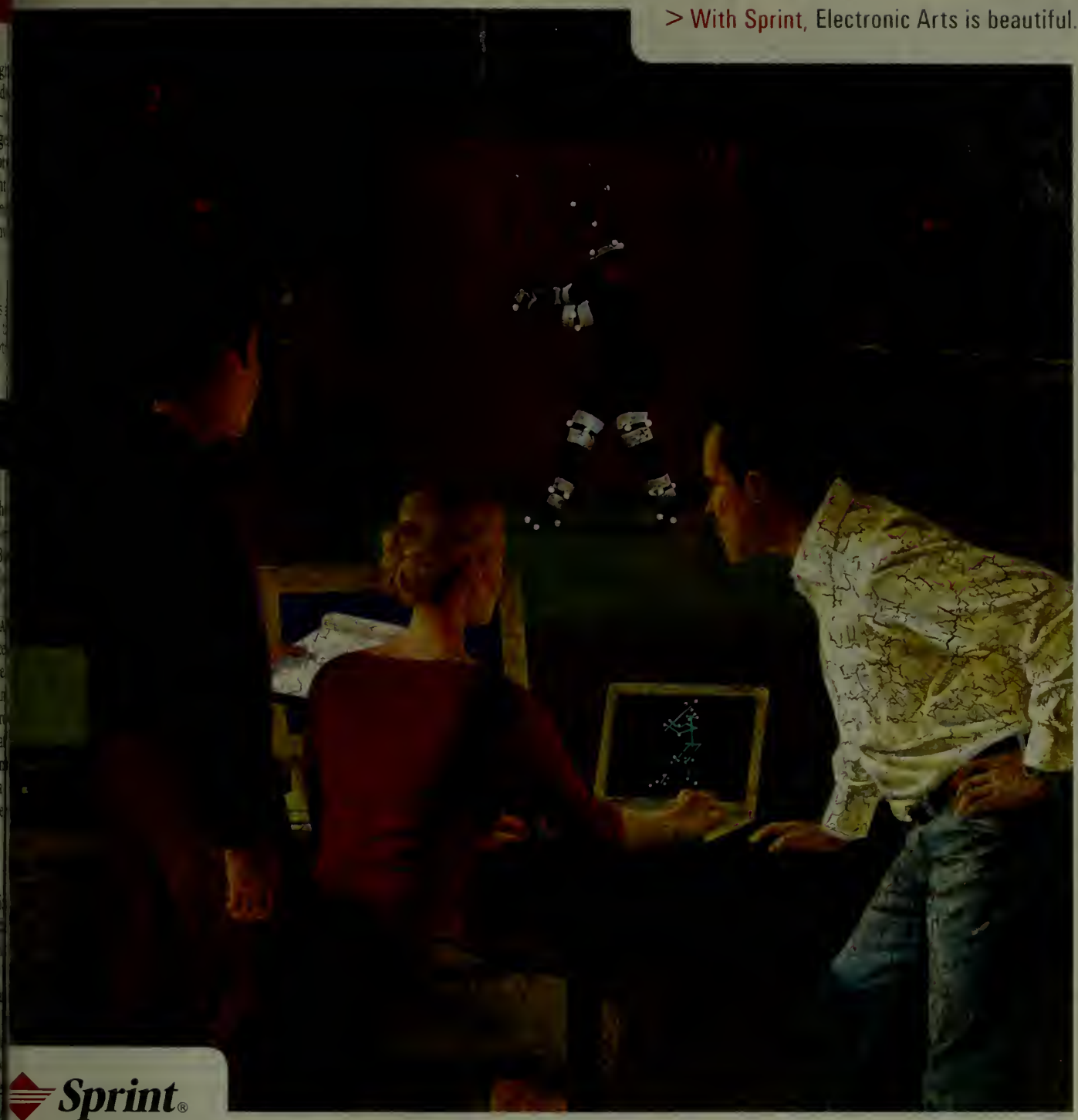
The CRP should be considered along with other markers for heart disease. Last year the American Heart Assn. and the Centers for Disease Control & Prevention recommended limited use of the test, saying it could be beneficial for people thought to have a midrange 10% to 20% chance of heart attack or cardiac death within the next 10 years, based on factors such as age, cholesterol levels, blood pressure, smoking, and the presence or absence of diabetes. In such cases, th could help a physician who is und about the course of treatment. B cording to Dr. Thomas Pearson, a p tive cardiologist and co-chairman group that came up with the AH recommendation, the CRP is unnec for patients at highest risk (since should be treated aggressively i case) or at low risk (since CRP would be unlikely to push such pa into a category requiring treatme such cases, says Dr. Pearson, a would be just an added expens could lead to overtreatment.

LOW-COST PEACE OF MIND

ON THE OTHER HAND, Dr. Ri Stein, a cardiologist and associate man of the department of medici Beth Israel Medical Center in New says the test can be done at no cha bundled with other common screens and can be performed usin same blood. Most cardiologists now tinely include the CRP in the batte tests ordered for their patients, th internists and family doctors are less ly to do so, he says. "I think it wou helpful for any man over 40 or woman over 45 who goes in for a ris sessment to have this test," says Dr. S

Given the latitude in the new g lines for when to use drugs to lower Dr. Stein says the CRP would help hi cide what to recommend. A 55-yea with an LDL level in the 100-to-130 r but a low CRP and no other heart di risks might get by with diet and life changes, he says, while someone wit same LDL but a high CRP and other factors should probably take a s drug. Even Dr. Pearson says the test's fulness has increased because of the cholesterol guidelines. ■

> With Sprint, Electronic Arts is beautiful.



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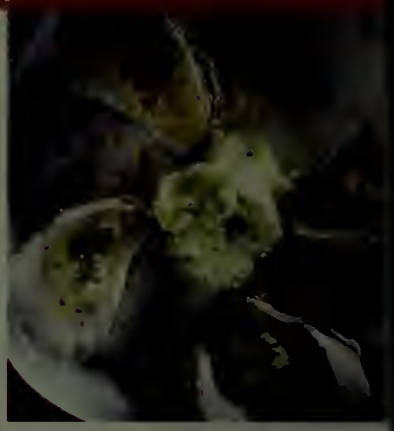

ENGLISH FARE The Merchant House serves oysters with caviar beurre blanc

Worlds Away from Bangers and Mash

The Shropshire town of Ludlow has become a mecca for foodies. **BY JANE BLACK**

IT LOOKS LIKE A TYPICAL ENGlish pub—a crooked, half-timbered building with seven polished wooden tables, antique copper pots, and the obligatory roaring fire. But there's no warm ale on tap here at the Merchant House. Instead we savor parsley risotto with English asparagus and wild mushrooms, sautéed scallops in lentil-and-coriander sauce, and pan-fried veal with foie gras. It's this kind of earthy, fresh, and generously portioned food that has made British culinary legends of Merchant House chef Shaun Hill and his adopted home, the medieval town of Ludlow. No wonder the wait for a weekend dinner reservation is at least six months.

Today, in addition to its picturesque ruined castle, Ludlow—about four hours northwest of London—boasts three restaurants with Michelin stars: the Merchant House, Mr. Underhill's at Dinham Weir, and Hibiscus, which even got a second star in January. No English town except London has more Michelin eateries.

Why Ludlow? Foodies have been lured by the quality of local livestock and produce. Indeed, the Shropshire countryside is filled with orchards, cornfields, and dozens of small, independent dairies and sheep and cattle farms. Ludlow also owes its success to skyrocketing real estate prices in other parts of Britain. Chris and Judy Bradley, proprietors of the one-star Mr. Underhill's, already had a Michelin star at their restaurant in Sussex in England's pricey Southeast when, six years ago, they decided to move to Ludlow. "We wanted a place where it was affordable to [illegible] into the [illegible] business," [illegible] Chris Brad[illegible]

As the [illegible] about Ludlow's restaurants sprea[illegible] met pilgrims poured into the tow[illegible] were also drawn by such foodie ev[illegible] the Magnalonga that takes place e[illegible] gust. Sponsored by the local [illegible] board, it's a six-mile walk throu[illegible] Shropshire countryside with five [illegible] each of which serves one part of [illegible] course meal. The annual Ludlow [illegible] es Food & Drink Festival, held eac[illegible] tember, offers an ale-and-sausag[illegible] and lectures such as "From Mont[illegible] to Willy Wonka: 3,000 Years of [illegible] late." Last year, the three-day food [illegible] tracted more than 15,000 tou[illegible] 5,000 more people than live in the [illegible]

FRENCH ROOTS

HILL'S MERCHANT HOUSE is Lu[illegible] first and most famous restaurant. [illegible] biscus is turning out some of the m[illegible] novative food. Chef Claude Bosi, [illegible] year-old wunderkind, trained [illegible] master chefs Alain Ducasse and [illegible] Passard in Paris—and with his [illegible] Yolanda Bosi, at a bistro she used [illegible] in Lyons. On the menu the day we v[illegible] lamb sweetbreads dusted with ging[illegible] pool of eucalyptus milk, roast Dove[illegible] with young leeks, and pear-glaze[illegible] cumber puree, a[illegible] dessert, crème [illegible] of Jerusalem [illegible] chokes, toasted [illegible] and caramel ice c[illegible] The prix fixe lunc[illegible] $46; dinner is $7[illegible]

It's a far cry [illegible] your typical E[illegible] Sunday lunch. [illegible] that's why a [illegible] 450,000 visitors [illegible] to Ludlow last [illegible] Food, at long las[illegible] become a B[illegible] tourist attraction.

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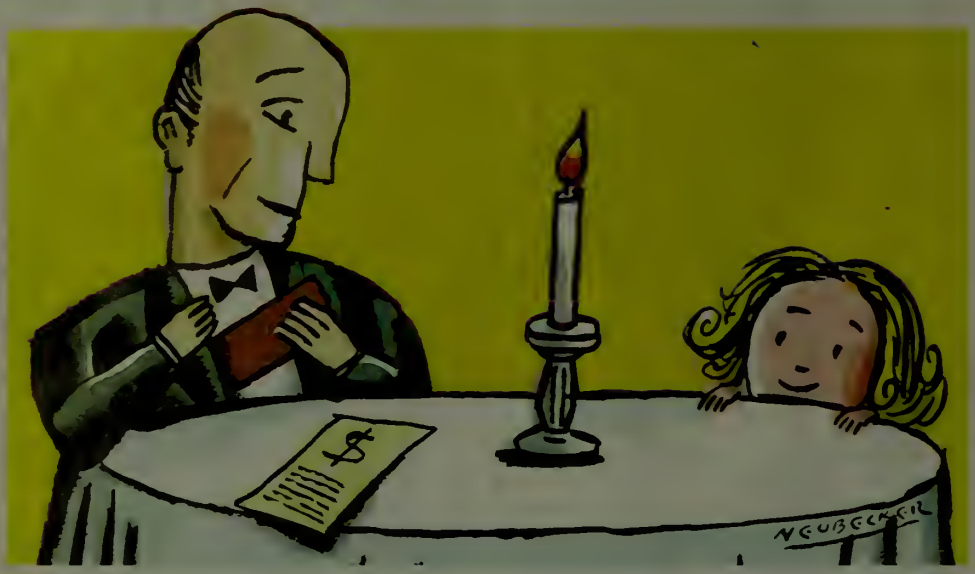
EDITED BY TODDI GUTNER



TRUSTS

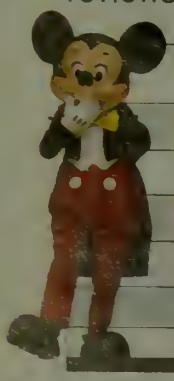
A Gift from the IRS

ATTENTION, TRUST-FUND BABIES: Now, you can have your cake and eat it, too. Thanks to a recent **Internal Revenue Service** ruling, the owners of a popular breed of trust—irrevocable grantor trusts—can now cover their trust's income-tax tab without fear of repercussions. Why pay someone else's taxes? Because if a trust owner (a parent or grandparent, perhaps) writes a check to Uncle Sam, the trust doesn't have to, leaving more money for heirs. Another benefit is that by paying the income taxes, trust owners can reduce their taxable estates, says Jere Doyle, a senior director at Mellon's Private Wealth Management Group.

The best part: It's all tax-free. Until now, the IRS hadn't clarified whether it considered the tax payment subject to a gift tax of up to 49%. But in its recent ruling, the agency indicated that no gift is involved. Still, for trusts drafted after Oct. 4 of this year, the ruling contains a caveat: If the trust is required to reimburse the owner for the tax bill, the trust's value will be included in the owner's estate. *–Anne Tergesen*

TRAVEL

If you're looking to book a vacation with the kids, Zagat's new *U.S. Family Travel Guide* just made it easier. Based on surveys of 11,000 parents, the guide rates 554 family attractions by child appeal, adult appeal, public facilities, and service. It also reviews 150 family-friendly hotels and 1,152 restaurants.



Top-Rated Attractions*

1 Magic Kingdom, Orlando	6 Disney-MGM Studios, Orlando
2 Epcot, Orlando	7 Metropolitan Museum of Art, NYC
3 American Museum of Natural History, NYC	8 Disney's Animal Kingdom, Orlando
4 Disneyland, Anaheim, Calif.	9 Bronx Zoo, NYC
5 Central Park, NYC	10 Yosemite National Park, Calif.

*[illegible] ed scores for child appeal, adult appeal, facilities, and service

Data: Zagat Survey of U.S. Family Travel Guide: Sites & Attractions, Restaurants, Lodging

GADGETS

SMARTER FANS BEAT THE HEAT

REMEMBER WHEN electric fans were about as low tech as you could get? Not anymore. The Deluxe Spire Feel-Good Fan from **Sharper Image** ($100, sharperimage.com), a slim, vertical model, blows out negative ions to freshen stale air. (Fresh air has higher concentration of negative i[illegible] oxygen molecules with an extra el[illegible] attached.) **Lasko Group's** Night Wat[illegible] Pedestal Fan ($35, laskoproducts.c[illegible] has a digital thermostat you can se[illegible] the fan shuts off if temperatures d[illegible] And if you want to cool off outside [illegible] **Hammacher Schlemmer's** Cool Mist [illegible] Outdoor Fan ($150, hammacher.c[illegible] connects to a garden hose and sen[illegible] a superfine mist. *–Kate M[illegible]*

FRESH[illegible] From [illegible] Image[illegible]

TIME OFF

CHINA IN TRANSITION

FROM A N[illegible] androgy[illegible] figure da[illegible] along the Great Wa[illegible] a crumbl[illegible] old build[illegible] set again[illegible] stark mo[illegible] skyscrape[illegible] the image[illegible] a new ex[illegible] on China reveal a society in transitio[illegible] "Between Past and Future: New Photography and Video from China" features 130 works by 60 young Chi[illegible] artists. It's on view through Sept. 5 a[illegible] New York's **International Center for Photography** and the **Asia Society & Museum,** with different works at each[illegible] Then it travels over the next two year[illegible] Chicago, Seattle, Berlin, and Santa Barbara, Calif. For a preview and a calendar of the tour, visit icp.org.

BY ROBERT BARKER

Psychiatric Solutions: You Might Be Shocked

rand jury in West Palm Beach this r exposed the shameful operation of rida Institute for Girls, a prison for ximum-risk and mentally ill teens. e causes of FIG's many problems are atable. Indisputable is the damage to s who were molested by men working Premier Behavioral Solutions, a te company hired by the state to run FIG. Two Premier rs were convicted of felonies. One had had sex in a oom with two different girls on the same day. und in default by the state for persistent failures at FIG, ier stopped running it in May, two years and $11 million of its contract. It still must defend itself against the ican Civil Liberties Union, which is suing Premier to public its FIG records. It also plans soon to quit running a prison, which it decided is not adequately funded. All in mess—yet not one that investors in Premier's parent, ville-based Psychiatric Solutions, would know about. iatric, whose stock is up 189% in a year and is pushed by Street as a hot grower, has disclosed none of Premier's les in Securities & Exchange Commission filings. This is ven though it filed its latest annual and quarterly reports s after it agreed in February to quit FIG.

HIATRIC EXECS SAID FIG is a unique situation, one the pany is moving beyond. They said Psychiatric is proud of ork in Florida, where as the biggest operator of juvenile ns it has won a commendable rating. They also noted that orida juvenile prison contracts, acquired in a 2003 merger, up a small part of total revenue. That slice is narrowing e company snaps up private psychiatric hospitals, its main egic goal. This year, the number of beds it owns or leases d past 4,000 from 2,800. From $294 million in 2003, ue this year may top $490 million, so Psychiatric sees its ses in Florida as too minor to disclose. "We report our 10- compliance with SEC regulations," CEO Jacobs said.

t it's easy to imagine that investors may be a shock. First, there are the ACLU suits. If CLU prevails, claims for damages by nts of girls who were mistreated at FIG will , predicts Frank Kreidler, the Lake Worth attorney pressing the suits. Psychiatric's rer, Brent Turner, said it has plenty of liability insurance. But its 10-K warns that punitive damages may not be covered. Second, while Psychiatric's first-quarter revenue jumped 190%, to $108 million, revenue excluding acquisitions rose 3% (table). Psychiatric has told the Street it expects revenue longer-term to grow at "strong single-digit" rates. Its loss of $15 million in annual revenue from FIG and now the boys' prison won't help. Premier has 10 more Florida contracts worth $23 million a year, expiring at various points through 2008. Its overall performance—successes, plus what happened at FIG—will weigh on the contract renewals, said the Florida Dept. of Juvenile Justice.

TROUBLE SPOT Florida Institute for Girls

If, as Psychiatric hopes, its expansion by acquisition pays off via stronger demand for behavioral health care, higher prices, and efficiencies, then FIG will be a blip. Yet Psychiatric also is a heavy user of debt. In eight deals over 12 months, it paid some $205 million, mostly on credit. Investors might want to recall Magellan Health Services, a behavioral health company that recently exited bankruptcy after rapid growth. I asked Magellan's CFO, Mark Demilio, what went wrong. "We increased the debt to do acquisitions," he said. Will Psychiatric necessarily follow suit? "We have ample liquidity to continue to execute" our expansion plans, says Psychiatric's Turner. Should investors reassess the risks the company faces? Not to would be foolish.

E-mail: rb@businessweek.com

Buying Growth

PSYCHIATRIC SOLUTIONS (PSYS)	
Total Revenue Growth*	190%
Revenue Growth, Excluding Acquisitions	3%

*Quarter ended Mar. 31 **Data:** Company reports

BY GENE G. MARCIAL

MORE FARMERS FERTILIZE WITH POTASH OF SASKATCHEWAN.

ARE RADWARE'S WOES AS DIRE AS WALL STREET IMAGINES?

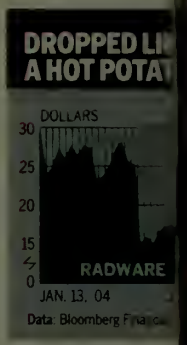
SLOT MACHINES ARE LIGHTING UP WELLS-GARDNER'S SCREENS

Hefty Yields from Potash

SOMETHING IS STIRRING at fertilizer giant Potash of Saskatchewan (POT): Analysts have raised forecasts for the second quarter—and for 2004 and 2005—expecting robust sales. Potash shares soared from 76 in March to 94 on July 21. As the world's No. 1 potash maker and No. 2 in nitrogen, "this company will reap huge gains from the limited supply and widening demand for these commodities," says Bill Harnisch, chairman of Forstmann-Leff Associates, which has a 2% stake. The dramatic drop in wheat and corn stockpiles has pushed grain prices higher. And with farmers making more money, outlays for nutrients are on the rise. That gives Potash new pricing flexibility, says Harnisch—which enhances earnings. David Silver of J.P. Morgan, who rates Potash (a client) "overweight," figures it will post second-quarter profits of $1.20 a share, up from the company's forecast of $1 and the first quarter's 94¢. For all of 2004, Silver sees $4—and $5 in 2005. But Harnisch sees much higher earnings: $1.30 in the second quarter, $4.75 for all of 2004, and $5.75 for 2005. "While the supply [of potash] worldwide is drying up, Potash still has large excess capacity," he says. Harnisch says this lopsided supply-and-demand picture will continue for several years. He expects Potash to hit 135 in a year.

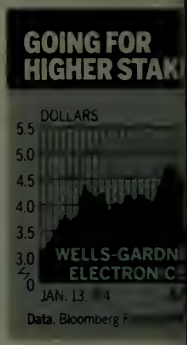
Radware May Gainsay The Naysayers

RADWARE (RDWR) got a taste of the Street's venom in May when it issued disappointing sales and earnings forecasts for the second quarter. The stock dived from 28 in April to 14 on June 17. It has since edged up to 17, but for investors, it's "show me" time for Radware. This Israeli company develops Internet traffic systems to improve clients' online productivity. The major culprit in the stock's fall is a 9% drop in U.S. sales, which account for 45% of the total. Radware was featured in this column on Oct. 20, 2003, when it was at 21. It hit 33 on Jan. 27, 2004. What's Radware's turnaround strategy? "We have stopped the bleeding by increasing our U.S. sales force and adding more engineers," says Chief Financial Officer Meir Moshe. Most analysts have lowered their earnings estimates. Steve Kamman of CIBC World Markets, who still sees the stock at 30 in 12 to 18 months, cut his second-quarter figure from 16¢ to 15¢ a share, and his 2004 number from 66¢ to 64¢, on sales of $65.7 million, vs. an earlier $66.3 million forecast. But a source familiar with Radware's operations is "almost sure" it will beat its own and analysts' estimates for the third quarter and for all of 2004. Radware will report its earnings on July 26.



As Gambling Grows, So Does Wells-Gardner

AMEX-LISTED Wells-Gardner Electronics (WGA) ha been around for 78 years, but Street analysts and institutional investors virtually ignore it. The stock jumped from 3 in January to 5.25 on July 21. In the past, W Gardner was best known for its screens for Pac-Man videc games, but it now makes video displays for slot machines other gambling devices. Of the world's 10 top makers of gambling devices, seven are Wells-Gardner customers, sa CEO Anthony Spier. Legislation is pending, he notes, to m slot machines and video lottery terminals legal in Maryland, New York, Ohio, Pennsylvania, Rhode Island, Macao, and Mexico—so Wells-Gardner's market should continue to expand. Leo Rishty, editor of market letter *Unique Situations* in Weston, Fla., who owns shares, sees yearly profits of 25¢ a share on sales of $55 million this year, and 50¢ on $60 million for 2005. In the first quarter ended Mar. 31, Wells-Gardner posted a profit of 4¢ on sales of $12.7 million. For all of 2003, it lost 11¢ on $46.68 million. On July 20, Haystack Capital reported that it owned more than 5% of the company. Says Haystack's Douglas Topkis: "Earnings are just starting to come in, so we may buy more shares." ■



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/ today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays. See Gene on Fridays at 1:20 p.m EST on CNNfn's *The Money Gang*.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor th firms hold positions in the stocks under discussion. Similarly, they have no investr banking or other financial relationships with them.

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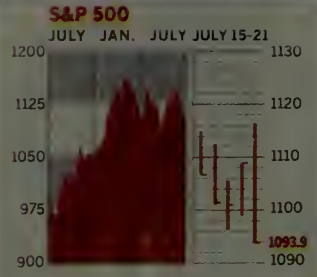
Personal Business Figures of the We

STOCKS



COMMENTARY

Stocks gave up ground in spite of Fed Chair Alan Greenspan's and Microsoft Chair Bill Gates's best efforts. First, Greenspan vouched for the recovery's durability. Then, Gates & Co. followed with a $75 billion gift to the investor class. The result? Stocks edged up, then down, despite strong profits from such outfits as Kodak and Pfizer. Hardest hit was tech, where hopes may have run too high.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	JULY 21	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1093.9	-1.6	-1.6	11.8
Dow Jones Industrials	10,046.1	-1.6	-3.9	10.4
NASDAQ Composite	1874.4	-2.1	-6.4	11.5
S&P MidCap 400	579.2	-1.0	0.6	18.7
S&P SmallCap 600	278.4	-1.5	2.9	23.8
Russell 3000	618.6	-1.6	-1.8	12.4
SECTORS				
BusinessWeek 50*	624.6	-2.3	0.4	7.9
BW Info Tech 100**	323.1	-1.5	-7.8	5.7
S&P/BARRA Growth	539.1	-2.0	-3.0	8.5
S&P/BARRA Value	550.7	-1.2	-0.2	15.1
S&P Energy	254.1	-0.6	13.3	32.6
S&P Financials	372.0	-1.2	-2.1	9.0
S&P REIT	121.8	0.4	5.2	19.3
S&P Transportation	200.0	-0.3	-1.0	11.2
S&P Utilities	121.0	0.0	2.2	15.7
GSTI Internet	141.0	-5.7	-2.5	12.2
PSE Technology	663.0	-2.5	-4.9	15.8

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	JULY 21	WEEK	% YEAR T DATE
S&P Euro Plus (U.S. Dollar)	1162.0	-1.7	-1.
London (FT-SE 100)	4377.3	0.1	-2.
Paris (CAC 40)	3637.5	-0.3	2.
Frankfurt (DAX)	3877.5	-0.5	-2.
Tokyo (NIKKEI 225)	11,433.9	0.1	7.
Hong Kong (Hang Seng)	12,395.1	3.9	-1.
Toronto (S&P/TSX Composite)	8454.2	0.0	2.
Mexico City (IPC)	9987.1	1.5	13.6

FUNDAMENTALS	JULY 20	WEEK AGO
S&P 500 Dividend Yield	1.67%	1.66%
S&P 500 P/E Ratio (Trailing 12 mos.)	20.7	20.8
S&P 500 P/E Ratio (Next 12 mos.)*	16.1	16.3
First Call Earnings Revision*	-0.25%	4.19%

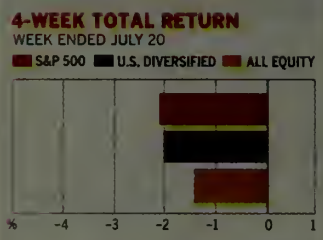
*F

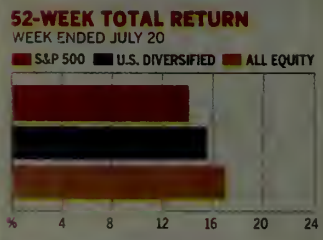
TECHNICAL INDICATORS	JULY 20	WEEK AGO
S&P 500 200-day average	1104.6	1102.1
Stocks above 200-day average	58.0%	60.0%
Options: Put/call ratio	0.79	0.85
Insiders: Vickers NYSE Sell/buy ratio	3.66	3.58

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Photographic Products	7.2	Internet Software	81.1
Steel	6.7	Oil & Gas Refining	78.7
Oil & Gas Equipment	5.1	Steel	74.6
Divsfd. Capital Mkts.	4.8	Fertilizers & Ag. Chems.	69.8
Fertilizers & Ag. Chems.	4.3	Divsfd. Metals & Mining	59.7

WORST-PERFORMING GROUPS	LAST MONTH %	
IT Consulting	-24.8	Airlines
Health-Care Distributors	-19.9	Health-Care Distributo
Semiconductors	-14.3	IT Consulting
Application Software	-13.6	Biotechnology
Internet Software	-11.2	Semiconductor Equip.

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Latin America	5.8	Natural Resources	40.4
Real Estate	4.0	Japan	38.5
Natural Resources	3.9	Latin America	33.0
Pacific/Asia ex-Japan	2.7	Europe	29.4
LAGGARDS		**LAGGARDS**	
Technology	-6.7	Technology	8.5
Small-cap Growth	-3.2	Large-cap Growth	9.2
Health	-3.1	Health	9.5
Large-cap Growth	-3.1	Domestic Hybrid	9.9

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
iShares MSCI Brazil Idx.	14.2	U.S. Glbl. Invs. Gl. Rscs.	68.8
Guinness Atkn. China & H.K.	8.4	Fidelity Japan Small Co.	68.0
Dreyfus Prmr. Gr. China A	7.8	State St. Rsch. Gl. Rs. A	66.6
ProFunds UltSh. OTC Inv.	7.3	ProFds. Wrlss. Ultsr. Inv.	64.1
LAGGARDS		**LAGGARDS**	
ProFds. Smlcdr. Ultsr. Inv.	-18.8	ProFunds UltSh. OTC Inv.	-29.7
Royce Technology Value	-13.5	Rydex Dynam. Vent. 100	-29.7
ProFds. Intnet. Ultsr. Inv.	-13.0	Ameritor Investment	-28.9
Reynolds	-12.6	Rydex Dyn. Tempest 500	-25.2

INTEREST RATES

KEY RATES	JULY 21	WEEK AGO
[illegible]	[illegible]	[illegible]
90-Day Treasury Bills	1.34	1.33
2-Year Treasury Notes	[illegible]	[illegible]
10-Year Treasury Notes	4.48	4.48
10-Year Treasury Bonds	[illegible]	[illegible]
30-Year Fixed Mortgage†	5.99	6.00

†BanxQ

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR
[illegible]	[illegible]	
Taxable Equivalent	5.46	
[illegible]	[illegible]	
Taxable Equivalent	5.69	

THE WEEK AHEAD

CONSUMER CONFIDENCE *Tuesday, July 27, 10 a.m. EDT* » The Conference Board's July confidence index most likely was virtually unchanged at 102. That's according to the median forecast of economists surveyed by Action Economics. In June, the index rose to 101.9.

DURABLE GOODS ORDERS *Wednesday, July 28, 8:30 a.m. EDT* » New durable goods orders for June probably rose 1.3%. In May, new orders declined for a second straight month, falling by 1.8%.

BEIGE BOOK *Wednesday, July 28, 2 p.m. EDT* » The Federal Reserve will release its overview of regional economic activity ahead of its Aug. 10 monetary policy meeting. The consensus forecast among respondents to the latest Action Economics survey is for the Fed to raise interest rates by 25 basis points again, to 1.5%.

EMPLOYMENT COST INDEX *Thursday, July 29, 8:30 a.m. EDT* » Compensation in the second quarter of 2004 probably increased by 1%, following a 1.1% gain in the first quarter.

GROSS DOMESTIC PRODUCT *Friday, July 30, 8:30 a.m. EDT* » The economy is forecast to have expanded by an annualized rate of 3.8% during the second quarter. In the first quarter, growth clocked in at 3.9%.

The *BusinessWeek* production improved to 222.6 for the ended July 10, an increase of from the previous year. B calculation of the four-week m average, the index slipped to 2

BusinessWeek onl

For the BW50, more investm data, and the components of the production index visit www.businessweek.com/magazine/ex

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The Real Middle Class Squeeze

WHO LIVES IN "THE CORE"? That's the twilight zone—core inflation land—the Federal Reserve visits every month to measure America's inflation rate. In the Core, people aren't worrying about rising energy or food prices because those necessities aren't counted in the official statistics for core inflation. And if they aren't counted, they don't exist. Taxes don't exist in the Core, either, so rising property taxes aren't bothering anyone. In the land of the Core, inflation is rising at only 1.9% annually.

Pardon us for being sardonic. Americans don't live in the Core, though most live in the Middle. And a genuine squeeze on the middle class is under way, in which higher prices for many key goods and services are outrunning rising wages and income. Rising prices have wiped out wage gains for the first half of 2004 (page 30).

Take health care. While median family income is up 8% from 2000 to 2004, health-care premiums for a family of four are up 49%. During this period, tuition at a four-year p college is up 40% (and 27% for private colleges). Day-c nursery school costs are up 19%. Total national propert are up 30%. And gas prices, of course, have jumped 23

The whole idea of excluding food and gas from the doesn't make all that much sense. Apparel, which is in in the Core, is often more v than food, which is not. An energy and gasoline prices such huge sectors of the ec that calculating the consum price index without energy describing the beach withou

Let's face it: Price hikes for key goods and services are taking a toll

Much of the political deb that will take place until th November Presidential ele will deal with the middle-cl squeeze. Economists can cr such abstractions as core in but politicians must deal w realities of voters' lives. Americans should ignore the partisan bickering and ideological posturing at the Democratic and Republican national conventions and analyze the specific proposals put forth by Senator Joh Kerry and President George W. Bush. They should ask tough questions: Which health-care plan, for example, the best chance of working? Do the numbers really ad After all, real voters don't live in the Core. They live in middle, and they are getting squeezed.

Analyzing Kerry's Health-Care Plan

THE U.S. HAS TWO problems with its health-care system: coverage and cost. Some 44 million Americans are not covered by health insurance and the nation's medical costs are among the highest in the world. Democratic candidate John Kerry's health-care proposals are strong on extending coverage and weak on containing costs. His plan is a good first step toward making sure all Americans get health insurance. But Kerry has to focus more on costs if he has any hope of selling his plan to independent voters in this election. He should do something radical—borrow from President Bush. Tax-free Health Savings Accounts promoted by Bush that allow individuals who buy high-deductible plans to pay for premiums and out-of-pocket medical expenses can generate big savings. In addition, Kerry can tap into the Medicare Drug Benefit, which is so wasteful that reforming it could help pay for much of his health plan.

The strength of the Kerry plan is that it builds on the employer-based and poverty programs that make up th existing health-insurance system (page 38). Extending would be easy. Kerry would expand Medicaid and the S Children's Health Insurance Program, which now cover poor families and children, to insure families of four wh up to $55,000 a year. He would help small business by creating a national pool of private insurance that is sim one already used by federal employees. And, in his most dramatic move, Kerry would have Washington pick up 7 company claims for catastrophic illness if companies ag to cover all their workers. With these initiatives, Kerry h to cover an additional 27 million uninsured people for $ billion over 10 years.

But how can he cover the cost? Kerry says he can pay his health plan and also cut the deficit by 50% by rolling the Bush tax cuts on the 2.3% of households making $200,000 a year or more. But that won't generate nearly enough money. Kerry should consider tapping into the $ billion already committed to the Medicare Drug Benefit. subsidizes the vast majority of seniors who are already covered or who can afford to pay for themselves. It also prohibits the government from negotiating directly with companies for lower Medicare drug prices.

By streamlining the Medicare Drug Benefit to defray ju the cost of very expensive drug bills due to catastrophic il and by getting Washington to use its buying clout to neg lower-priced drugs, Kerry just might save enough to pay his plan to extend health insurance. That would help solv of America's health problems—coverage and cost.

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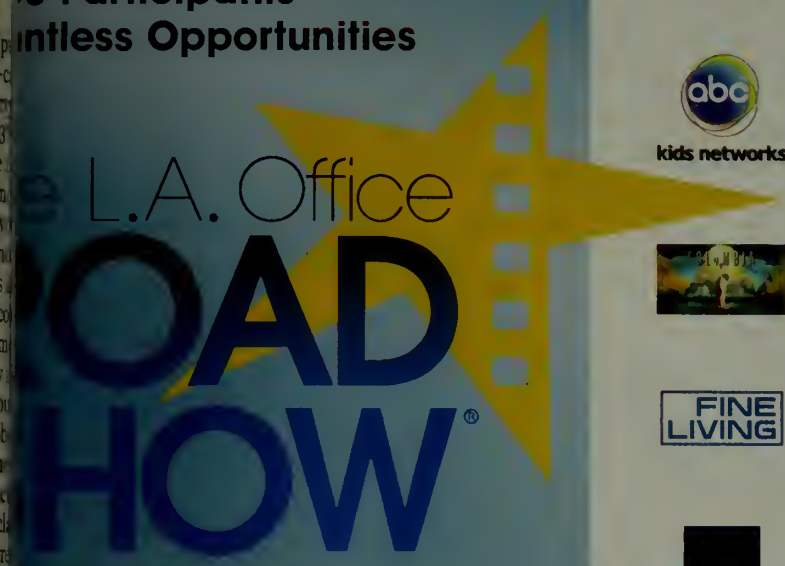

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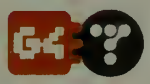

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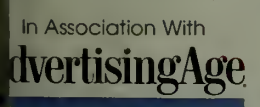

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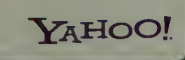

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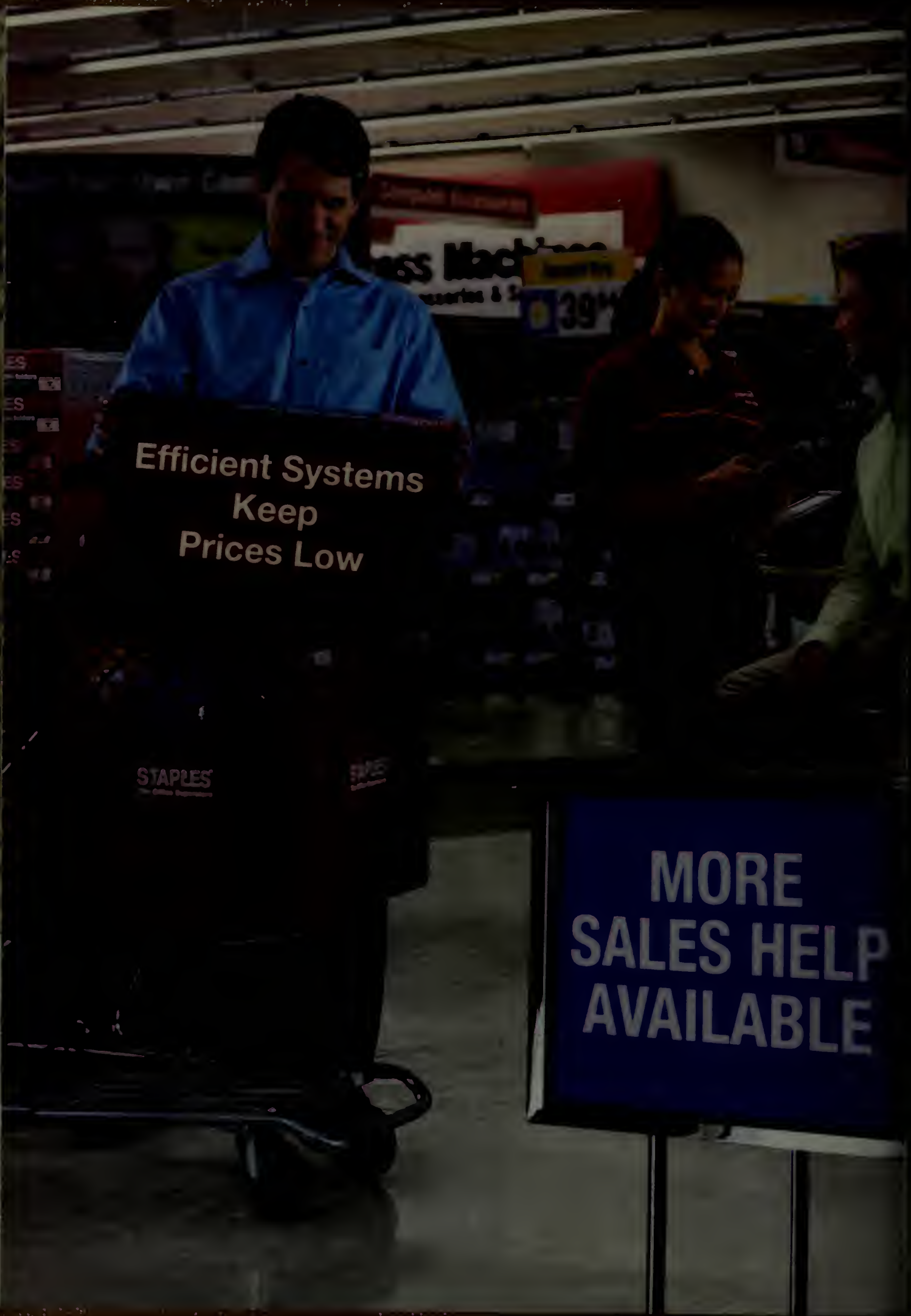
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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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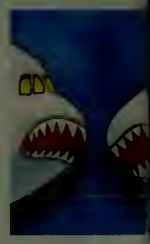
Chipmakers' Problems Are Speeding Up

As the industry tries to pack more power and performance into semiconductors, it faces delays, sliced profits, and overheating chips. To keep up, it will have to invent its way out of this trouble

Summer Vacation for the Economy

Sure, weaker consumer sales and factory orders in June suggest that growth has slowed slightly. But S&P Chief Econom David Wyss says still-high consumer confidence, strong home sales, and more jobs could easily jump-start activity

It's Time to End the Boeing-Airbus Dogfight



Endless bickering over who's violating a 1992 agreement that set limits on government aid for the development of commercial aircraft shows that a new, more transparent deal is needed

Investing Lessons from Martha Stewar

You can learn a lot about what not to do from the disgraced domestic diva. She ignored the advice of her broker, didn't diversify, and hated to sell, proving that even savvy folks have trouble beating the market

How Microsoft Can Embrace Linux

Considering Redmond's slim odds of conquering the software market in developing nations, why not offer them a low-cost Linux version of Office?

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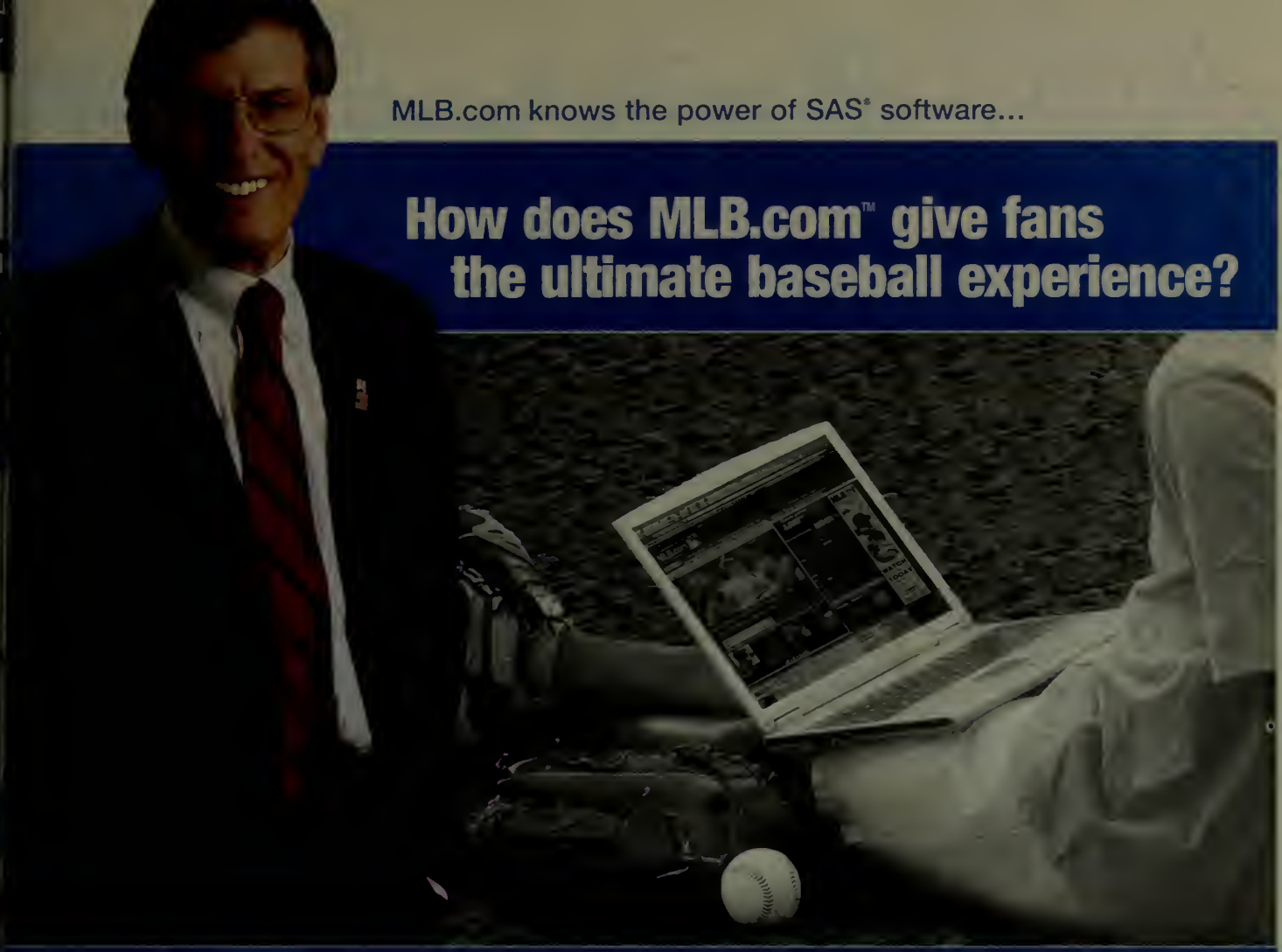

Allan H. "Bud" Selig, Commissioner of Major League Baseball

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Y... PY FROM AWEI?

INCE it got sued by rival Systems in 2003 for ctual-property viola- Chinese networking any **Huawei Technologies** en trying to repair its ation. That may be lt. *Business-* has obtained 21 letter the general el of **Fujitsu rk Communi-s** to Huawei Ren Zheng- aiming that a vei employee was caught to filch information on products at a recent show in Chicago. cording to the letter, Yi hu was discovered after in Fujitsu's booth ving the casing from a illion piece of networking and taking photos of the it boards inside. A secur- ard confiscated the

HUAWEI

Nortel, and **Tellabs** got the letter, suggesting Zhu may have had information on some of their products as well. Zhu was wearing a badge saying he worked for "Weihua," the letter says. But a source says he had a Huawei business card.

Fujitsu gave the photo card and notebook to the FBI. "The only logical conclusion that one can draw is that the employee in question was engaged in unlawful activities that may have been a violation of the Economic Espionage Act of 1996," says the letter from Melanie Scofield, the Fujitsu unit's chief legal counsel.

Scofield couldn't be reached for comment, but a Fujitsu source says it will not press charges. The FBI declined comment. Other companies say they have not heard from the Feds. Coincidentally, on July 28 Cisco dropped its lawsuit because Huawei passed a review to prove it had cleaned up its act.

Huawei says the FBI has not gotten in touch. It calls the incident "an unfortunate misunderstanding" and is trying to determine if disciplinary action is needed. Zhu is still working, but with reduced pay. *–Peter Burrows, with Bruce Einhorn*

cause of the potentially sensitive nature of this information, the only logical conclusion that is that the employee in question was engaged in unlawful activities which may have been of the Economic Espionage Act of 1996 (18 U.S.C. §§ 1831 and/or 1832). By this letter put on notice that such behavior will not be tolerated by FNC or any other companies been affected by your employee's actions.

ve forwarded all of the materials to the Federal Bureau of Investigation (FBI) in Dallas.

o card in s digital era, along a note- containing notes and rams of other suppliers' AT&T, Cisco, Lucent,

TO HUAWEI: A warning from Fujitsu

REAGAN No boost for Alzheimer's research

CHARITY CASES

Nancy's Neglected Plea

AFTER RONALD REAGAN'S death on June 5, at least eight bills were introduced in Congress—to put him on the $20 bill, to attach his name to various buildings, and even to create a new public holiday. But widow Nancy Reagan's request that people donate to the largest Alzheimer's charity has yet to generate many donations. Such an appeal usually swells coffers, but the **Alzheimer's Assn.** in Chicago hasn't seen a spike. It expects to raise $52 million in 2004—level with last year. Yet the charity says it won't trumpet Reagan's plea. "We don't want to exploit our close relationship with the family," says spokesperson Kathryn Kane. The former First Lady declined comment.

Congress could help: A recent bill would double the **National Institutes of Health's** Alzheimer's budget, to $1.4 billion. But rising deficits could make that impossible. Plus, some pols are leery of Alzheimer's—and any related stem-cell debates. A spokesperson for Representative Dana Rohrabacher (R-Calif.), who sponsored the $20 measure, says: "Putting his image on a $20 bill is much less controversial." But a lot less helpful to Alzheimer's patients. *–Jessi Hempel*

PHOTOGRAPH BY SIPA PRESS; (LOWER LEFT) GRAPHICS BY DAVID RUDES/BW

UPFront

SILICON SAGAS

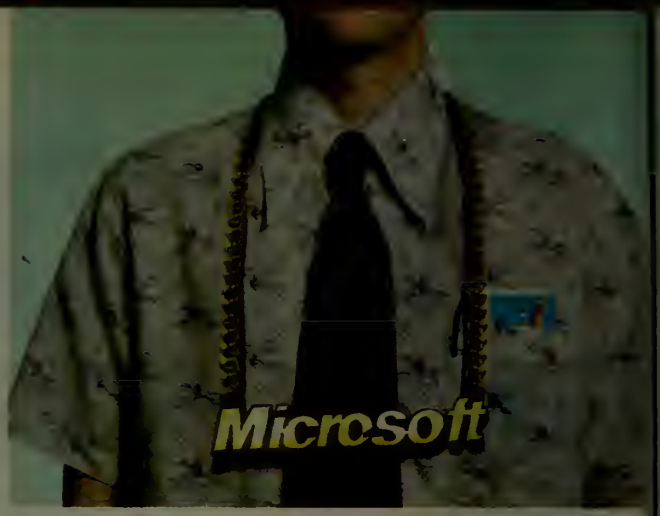
MOHSEN: A HIT ON THE JUDGE?

HOW QUICKLY a life can unravel. A year ago, Amr Mohsen was a respected Silicon Valley executive living in a Los Gatos (Calif.) mansion. Now he's in jail—and accused of taking a hit out on a judge.

Mohsen's woes started in 1998, when the then-CEO of software company **Aptix** allegedly tried to doctor documents to win a civil patent suit, later dismissed. But during the trial he allegedly committed perjury, which he denies. Federal District Judge William Alsup referred the case to the Feds. Alsup then decided to hear the resulting criminal case, over Mohsen's objections. In March, Mohsen tried to flee the country but was arrested (BW—Apr. 19).

PRISONER Calls were monitored

He has been in jail since, but may have found ways to dig his hole even deeper. According to an FBI affidavit, even though he was warned his calls would be recorded, Mohsen called his daughter—a psychology student—to find out what constitutes insanity, just before claiming he was incompetent to stand trial. In May, the affidavit says, Mohsen asked an inmate to make threatening calls to five witnesses and to hire someone to burn down another one's home. Days later, as a video camera rolled, he asked the inmate to have Alsup killed. Told it would cost $25,000, he said: "That's very high ... I heard it's more like $10,000." Mohsen's lawyer did not return calls. *–Peter Burrows*



HALLOWED HAULS

HAPPY RETURNS Microsoft's $3-per-share one-time dividend could give a nice kick to Seattle economy. Excluding execs, Microsof employees—current and former—living nea own 1.2% of the stock and will get $384 mill from the payout, estimates economist Dick Conway. Of course, bigwigs will see the mos from the dividends, expected to be paid on D 2. In addition to Bill Gates and Steve Ballmer who own nearly 15% of the company, Group Vice-President Jeffrey Raikes will net $25 mi lion. Board member Jon Shirley, who was president from 1983 to 1990, gets $7.6 millio With a little trickle-down, it'll be a nice Christ gift for Seattle businesses. *–Olga K*

STREET NEWS

FIDELITY FLAUNTS ITS BONA FIDES

LAST YEAR'S $1.3 BILLION settlement mandated that 10 Wall Street firms must provide investors with outside opinions on their stock advice. Now, some firms that weren't slapped by regulators seem to view such reports as a competitive threat.

Fidelity Investments will soon add research from seven new independent firms, such as **Ford Equity Research, Thomas White International,** and **Callard Research.** That gets Fidelity up to par with its admonished rivals.

–Mara Der Hovanesian

DRAWN & QUARTERED

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UPFront

FACE TIME

MARC BENIOFF

BURNED BY THE SPOTLIGHT

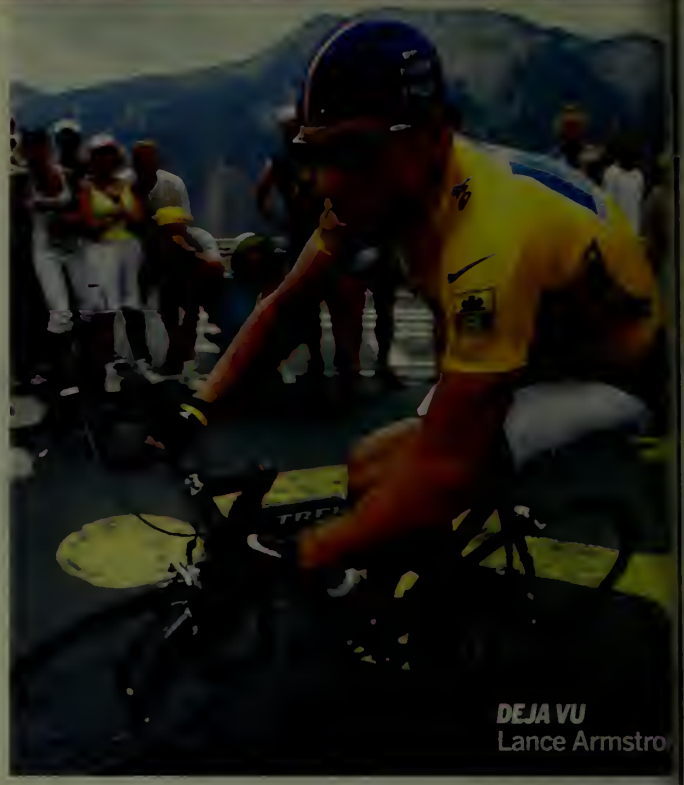
Marc Benioff revels in media attention. But he's smarting from the turn it took on July 21. The loquacious CEO of Salesforce.com had just come off a months-long "quiet period" from his company's initial public offering. In June, the maker of customer-management software had one of the strongest IPOs of the year, with its stock rising 56% on the first day, to $17.

The ban off, Salesforce told analysts and press it had set a sales target of $160 million to $165 million for this fiscal year, ended Jan. 31, up from $96 million last year. Within hours, the stock plunged 27%, to $11, zapping $120 million from Benioff's stake.

What happened? News reports noted that the target missed analysts' forecasts, and investors panicked. But those reports were prepared without company guidance. The stock has recovered a bit, to $13. "We're in the limelight all the time," Benioff says. "The downside is that there's a level of disbelief at how well we're doing." Now Benioff has to win back investors' trust. *–Steve Hamm*

LEISURE

THE TOUR DE FRANCE'S OTHER WINNER



DEJA VU Lance Armstro

WHEN LANCE ARMSTRONG crossed the finish line to clinch a record sixth Tour de France victory on July 25, no one applauded more loudly than execs at **Shimano**. That's because Armstrong rode a bike that was powered by Shimano pedals and cranks, shifted with Shimano derailleurs, and slowed (only occasionally, of course) by Shimano brakes. In the past two decades the Japanese company has become the dominant supplier of parts for higher-end models. "They're the Intel of the bike business," says John Burke, president of **Trek Bicycle**.

The key to Shimano's success is its commitment to research. Every year, the $1.3 billion company dispatches more than a dozen employees to work with manufacturers and retailers for several months at a stretch to gauge consumer trends. And company officials regularly meet with top racers such as Armstrong to discuss products and prototypes.

Still, Shimano can hardly afford to coast. Even as two-wheelers enjoy increasing favor in the U.S. because of Armstrong's success in the Tour, the long-term trend is down. And as more bikes are built in China, parts makers have popped up to supply mainland manufacturers. Most are small now, but t could become formidable rivals if they can bring the quality up. So Shimano is shifting production to Ch to stay cost competitive; i opened its second factory there in April. For now, though, Shimano rules high-end bike component just as surely as Armstron dominated this year's Tou de Lance. *–Brian Bremn*

MOVIES

GETTING ANIMATED This fall will see the latest battle between Pixar and DreamWorks, just as the latter's IPO road show is expected. DreamWorks' *Shark Tale* debuts on Oct. 1, and a month later, Disney releases Pixar's *The Incredibles*.

	PIXAR	DREAMWORKS
Revenue	$262.5*	$295.6
Earnings	$124.8	$189.1
Highest Box Office Gross (*Finding Nemo*)	$339.7	
Highest Box Office Gross (*Shrek 2*)		$429.8**
Oscar for Best Animated Film	1	1

Data: Company filings, Internet Movie Database, Inc., Variety. * In amounts in millions. ** As of 7/27

THE STAT

12

The number, in millions, of workers employed by charity, advocacy, and religious groups. That's up from 7.7 million in 1977 and now totals 9% of the U.S. workforce.

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CELEBRATING 75

As part of its anniversary celebration, BusinessWeek *is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. In late September, 2004,* BusinessWeek *will publish a special commemorative issue on Innovation.*

King of the Discounters

IN 1967, A LEAN, TANNED visitor from Arkansas came to see Kurt Barnard, then the head of a discount retailers' trade group in New York. Barnard recalls promising the man 10 minutes. But for more than two hours, the intense Sam Walton grilled him on every aspect of discounting, taking notes all the while.

Walton already showed the drive that would turn his Wal-Mart discount chain into the world's largest company. His simple business model, with its fanatical focus on low costs and low prices, changed the way Americans shop. But the chain's impact goes beyond cheap underwear. With its unparalleled size and efficiency, Wal-Mart Stores Inc. has dampened inflation and driven productivity gains throughout retailing and manufacturing. It also has been attacked for holding down wages, hastening the shift of production jobs overseas, and decimating small-town merchants.

Born in Kingfisher, Okla., in 1918 and raised in Missouri, Samuel Moore Walton stumbled into retailing. He honed his competitive drive on the high school football field. At the University of Missouri, where he earned a business degre 1940, Walton waited tables, worked as a lifeguard, and managed newspaper routes, earning more than $4,000 a year. He contemplated business school but couldn't affor So he took an offer to be a J.C. Penney Co. management trainee. "I got into retailing because I was tired, and I wa a real job," he wrote in *Sam Walton: Made in America.*

Walton's wife, Helen, was responsible for one strategy fueled Wal-Mart's success: its early focus on small towns. Helen refused to move to any town with more than 10,00 people. So when Walton was ready to start his own Ben Franklin variety store as a franchisee in 1945—borrowing $20,000 from Helen's dad—th landed in tiny Newport, Ark. Walton's small-town focus forc him to build his own distributi and communications systems. Those systems became critical gathering and analyzing the da that Wal-Mart uses to push suppliers for everything from lower prices to better packagin

Sam Walton relentlessly studied and borrowed from rivals

Sensing that his variety stor could be steamrolled by the powerful new concept of discounting, Walton jum in with his first Wal-Mart Discount City in Rogers, Ark., in 1962—the same year that rivals Kmart anc Target got their start. Walton studied his competit and borrowed liberally. Even the hokey Wal-Mart cheer was based on one Walton heard at a factory South Korea. Walton took his 32-store chain publi 1970. Last year, Wal-Mart hit a once unthinkable $ billion in sales, $9.1 billion in profits, and more tha 4,900 stores around the world. Its dominance has created a backlash from unions, antisprawl activis antisweatshop watchdogs, and plaintiffs' lawyers.

Before his death at 74 in 1992, the visionary Wa was already pondering some of the issues now crit to his company: Could a $100 billion retailer be as efficient as five $20 billion retailers? How would W Mart guard against abusing its power? Critics say zeal for cost-cutting set the stage for some of the controversies that now dog Wal-Mart. But for bett worse, Walton's mission to serve as the "agent" fo consumers has changed retailing forever. ■

–By Wendy Ze

Middleware is Everywhere. Can you see it?

5 1 4 3 2

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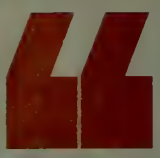
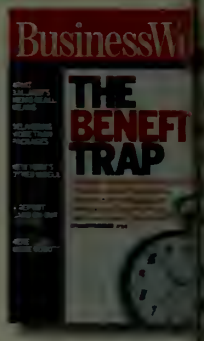


Bank A expects that... [it will] reap whatever is left over in a bankruptcy. Why are the debts owed to employees different?"

–Timothy J. Dayton
Sault Ste. Marie, Mich.



FINDING A WAY OUT OF THE PENSION MAZE

"THE BENEFITS TRAP" (Cover Story, July 19) by Nanette Byrnes was outstanding. Few people understand the seriousness of the switch from defined-benefit to defined-contribution plans. This is clearly demonstrated by the declining, not increasing, national savings rates as well as record levels of personal debt. My personal feeling is that employers' pension trusts are probably in more trouble than the article implied. This is a consequence of employers assuming future returns of 8% and higher for trust portfolios that have a large bond component, especially if we have just a couple more years with mediocre stock performance.

Thanks to *BusinessWeek* for an article that warns of impending financial trouble instead of pandering to many in the financial industry and government who want us to believe that the future is bright and shining, so that we'll spend more and save less.

–Henry K. Hebeler
Kent, Wash.

Editor's Note: The writer, former president and also chief forecaster for Boeing Co., runs a Web site, analyzenow.com, that gives advice on financial plann for retirement.

I CANNOT UNDERSTAND why emp ees' deferred wages—the pension pla is not considered a debt of the comp and one that should take its place other debts that the company owes. B A expects that its loan will be repaid that if it has the senior debt that it stand at the head of the line to reap wh ever is left over in a bankruptcy. Why the debts owed to employees differe The date for those obligations for p sions should go back to the start of pension plan and would likely be the s ior debt obligation for many compani

Banks should have to stand in line hind the pension plan if they lent mo after the start of the pension plan. T would require companies to keep with their pension obligations in or to float more loans.

–Timothy J. Day
Sault Ste. Marie, M

YOUR ARTICLE DID NOT explore more far-reaching initiatives that are dermining defined-benefit plans, disco aging Corporate America from mainta

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:RECTIONS & CLARIFICATIONS

he top 100 brands" (Global Brands eboard, Aug. 2), certain brands' ntries of ownership were incorrectly d. The correct listings are: Chanel, ce; and Yahoo!, U.S.

he stem-cell flap: Simmer down" vs: Analysis & Commentary, July 26) correct date of Ronald Reagan's death is 5, not June 6.

new antibody treatment described in ARS vaccine from survivors' cells" velopments to Watch, Aug. 2) does not ilize the patient's immune system, and uld not be called a vaccine.

is critical element of our national ment strategy. The U.S. corporate on system is facing a series of unco- ated accounting, legislative, and atory proposals from the Financial unting Standard Board, ratings cies, the Treasury Dept., and others, being pursued in the name of im- ng or safeguarding the system.

e Committee on Investment of Em- e Benefit Assets (CIEBA) surveyed embers and sponsored independent rch, in which approximately 50% of urveyed plan sponsors indicated that ing plans for current or future em- es was a possible or very likely re- se to the pending initiatives. Further, of CIEBA members surveyed would a significant change in their asset ation, increasing pension costs and cing benefits for millions of partici- s, if these initiatives are adopted. The cussions would further negatively t the stock market, employment , and the economy.

EBA is calling on America's legisla- regulators, and academics to develop ordinated approach that ensures the -term viability of defined-benefit plans e enhancing the overall system. This is ical first step in developing a cohesive -term national retirement system that esses the 77 million baby boomers beginning to approach retirement.

–Gary A. Glynn, Chairman
Committee on Investment
of Employee Benefit Assets
New York

or's Note: CIEBA is a membership or- zation of the Association for Finan- Professionals that represents more 110 of the nation's largest pension ls. The writer is president of U.S. Steel Carnegie Pension Fund.

AS YOU STATED, health benefits, particularly retiree health benefits, are most at risk because there is no "safety net." There is a terrible irony in all this: Health insurance has too long been connected to employment. My father, Carroll Daugherty, was chairman of a Presidential board that in 1949 settled a long steel strike and pioneered health benefits for workers. That, at the time, was cheaper than giving pay increases.

–James C. Daugherty
Bradenton, Fla.

THE SOONER LABOR leaders, union employees, and corporate leadership learn that "they must hang together or hang separately," the better off all of them will be.

–Jack J. Crocker
Palm Desert, Calif.

CONSIDER THIS MAJOR economic difference between the West and the East, with whom we now uncomfortably compete: We Westerners stress self-sufficiency, pushing our young out of our nests upon adulthood and assuming we will enjoy a life of ease as we turn gray. In Eastern developing countries, however, extended families often live together and pool their resources. It may be time to reconsider. Reconnecting the generations could solve a number of logistical, economic, and developmental problems. As a 43-year-old white-collar worker who is between careers and with virtually no retirement savings, it has occurred to me that I should make nice with my children now because we might need to enjoy a harmonious, long-lasting relationship from here on out.

–Jennifer Kirley
Greene, Me.

ACCORDING TO YOUR July 19 issue, the two biggest problems facing U.S. businesses are the costs of benefits (Cover Story) and the the huge amounts of excess cash from record profits ("Stuffed with dough," News: Analysis & Commentary). Many companies that are complaining they cannot compete because of benefits costs are sitting on huge sums—IBM was mentioned prominently in both stories. As you pointed out, many companies imprudently did not make any contributions in the late 1990s, when pension funds got overfunded, but now are begging for relief when they are underfunded. If management, aided by government, would start living up to its responsibility to workers, the entire economy and country would be better off.

–Michael D. Myers
Lutherville, Md.

SETTING THE RECORD STRAIGHT ON AMD CHIPS

"WHAT INTEL'S OPPONENTS are up to" (Technology & You, July 5) states: "The Athlon 64 can run existing 32-bit [Microsoft Corp.] Windows XP and applications, but they take a toll on performance." In fact, the Advanced Micro Devices Inc. Athlon 64 FX processor runs 32-bit software faster than any other PC microprocessor today. AMD designed the AMD64 architecture to run both 32-bit and 64-bit applications side by side without any performance penalties. Multiple benchmarks prove that we succeeded.

–Matty Seyer
Vice-President & General Manager
AMD Microprocessor Business Unit
Austin, Tex.

Editor's Note: Our statement referred to the chip's performance running 32-bit software relative to its performance running 64-bit software.

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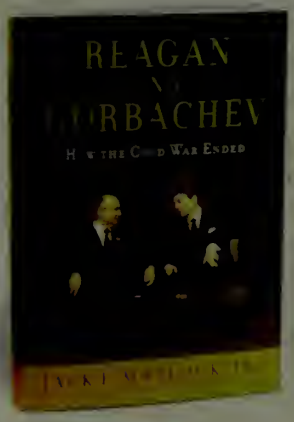
Inside the Great Thaw

REAGAN AND GORBACHEV How the Cold War Ended
By Jack F. Matlock Jr.; Random House; 363pp; $27.95

Give Jack F. Matlock Jr. credit: He turned Ronald Reagan into a detail man. On the eve of the first summit between Reagan and Mikhail Gorbachev, in 1985, National Security Adviser Robert McFarlane was struck by Reagan's poor command of the facts on the Soviet Union. That's when Matlock, the National Security Council's Soviet expert, ordered up a series of reports by Administration experts, dubbed "Soviet Union 101." Reagan read the 21 papers carefully, scribbling notes and grilling the authors. He also met with specialists on Soviet culture and finally held a mock summit—with Matlock playing Gorbachev. It paid off: Reagan was better prepared than Gorby was.

The education of Ronald Reagan is one of many absorbing recollections in Matlock's *Reagan and Gorbachev: How the Cold War Ended*. A career diplomat and Russia expert first posted to Moscow in 1961, Matlock served in the NSC from 1983 to 1986 and then as U.S. Ambassador to the Soviet Union until 1991. Having overlapped with him as a Moscow correspondent in the mid-1980s, I found his book an intriguing insider's look at superpower diplomacy in a period featuring high-stakes arms-control negotiations, numerous spy flaps, and four summits.



The author excels in his descriptions of U.S. policymaking, infighting and all, and also in giving the Soviet side of events, based in part on interviews with Gorbachev and other Kremlin officials. His portrait of Reagan as a moderate is particularly surprising. But Matlock doesn't provide enough insight on complex economic problems that were forcing Gorbachev to make sweeping arms-control proposals and political reforms.

Matlock portrays Reagan as deeply committed to improving relations with Moscow, despite his talk about the Evil Empire and his resolve to resist Soviet adventurism. As early as 1983, Reagan pushed for a more constructive negotiating stance with the Soviets and maneuvered to create conditions for a summit. The President, Matlock startlingly suggests, was aligned with the moderates in his Administration.

The hard-liners of both camps take their lumps in this account. When Defense Secretary Caspar W. Weinberger opposed a particular decision, he was prone to leaking "distorted" information to the press, says Matlock. Reagan tolerated such leaks and those of others, although they sometimes "infuriated" him. Reagan "understood that he would need the acquiescence, if not the active support, of the hard-liners . . . if he was to implement a positive agenda with the Soviet Union," Matlock says. On the Soviet side, Fore Minister Andrei Gromyko—better known as "Mr. Nyet"- plays the heavy. "On policy issues," writes Matlock, "he as rigid as his public image suggested." Early on, Gorba ousted Gromyko, telling his replacement, Eduard Shevar nadze: "Our foreign policy needs a fresh eye, courage, dynamism, innovative approaches."

Gorbachev's motives for that sort of change get obscu by Matlock's tight focus on diplomatic maneuvering. Mo significant, Matlock places too little emphasis on Russia' dismal economics. Forty pages from the book's end, he s that "domestic reform had become Gorbachev's prime concern" by 1988. Actually, the domestic economic crisis Gorbachev's prime concern when he took power in 1985 propelled him to cut arms deals with the U.S. and to try t thwart Reagan's Strategic Defense Initiative.

Matlock's judgment is also clouded by his irritation wit U.S. media. He singles out *The Washingto Post* for ignoring "official statements that failed to conform to their preconceptions. And during a 1984 White House photo o Gromyko and Reagan, he's irked by the p attention. "I watched the process with growing impatience . . . but neither Reaga nor Gromyko seemed to mind. Both want as much publicity as possible," he says. Matlock is blind to the power of publicity, while both Reagan and Gorbachev were p at using it to push their agendas.

To his credit, Matlock admits his own failings. He tried without much success t create informal channels fo discussion with the Soviets. ideas on how to solve a 198 spat over spying were dismi by the State Dept. And in 19 when Reagan requested a speech to unveil a new initiative, Matlock gave him draft that the President call "pedestrian." Reagan gave speech anyway, writing the most memorable part himse an appeal to "Ivan and Anya" for peace.

Matlock shows Reagan's deep commitment to improving Soviet ties

Matlock recognizes one central truth: Neither Reagan Gorbachev could have accomplished as much as they did without the other. "Gorbachev cooperated with Reagan t the Cold War," concludes Matlock, "and Reagan cooperat with Gorbachev to legitimize the democratic process with Soviet public." Both took risks. As Matlock says, "they did always get things right, but on the most critical issues, the finally did." We're all better off for it. ■

–By Joyce Barna

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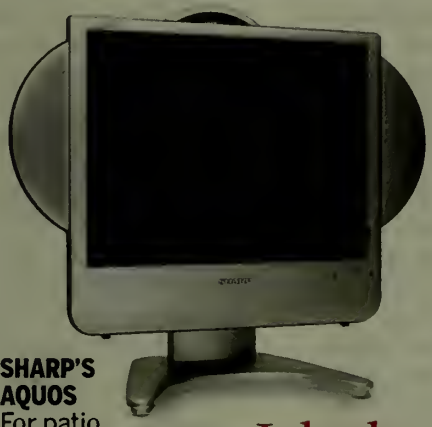
BY JAY GREENE

Now Your TV Can Go Wireless, Too

e often thought that the worst business to be in these days is wire and rd manufacturing. First phones went cordless. Then mice and yboards—followed in short order by entire home computer networks. ow, consumer-electronics companies want to turn televisions into reless gizmos. The trend began in Japan, and for the past few weeks, I've

n test-driving the first model to hit shores, Sharp's Wireless Aquos. e's how it works: Connect your cable up to three other video sources— , TiVo, and the like—to the Wireless os base station. Turn it on, switch on separate 15-inch LCD screen, and just that, you're watching wireless TV. No ngs to futz with. It just works.



SHARP'S AQUOS
For patio potatoes

DESIGN IS NOVEL, even elegant. The e station is an unobtrusive slab about nches square and two-and-a-half nes deep. The screen looks like it was pired by Mickey Mouse, with two ear- speakers on either side. When you're ly to go mobile, unplug the charger from the side of the een, grab the sturdy handle to remove it from its stand, you're off. At 12 pounds it's not too hefty to tote around house. And a built-in easel steadies the screen, so you can it up on a patio table or kitchen counter.

The screen has a lithium-ion battery that lasts for three urs if you are willing to watch in the darkest, energy-saving de. Bump up the brightness and you lose about an hour of tery life. That means you might catch two-thirds of a eball game out on the patio. But for the last few innings, 'd need to dash inside.

This is a minor hassle, compared with a bigger rtcoming. Bluntly put, the Wireless Aquos isn't very good being wireless. The base station transmits its signal to the een using early Wi-Fi technology known as 802.11b. That ems an odd choice because the newer flavor of Wi-Fi, 2.11g, zips signals more quickly and at a slightly longer nge. Sharp's literature claims that the monitor will work up 50 feet from the base station. But in my house, images uld freeze in as little as 25 feet. You can tweak the settings longer distances—more easily than on a PC Wi-Fi twork—but I was only able to eke out a few more feet.

One of the challenges with Wi-Fi is that it uses the same quency as some cordless telephones and microwave ovens. an ill-timed phone call or food run in the kitchen can cut the signal from the base station. Sharp says a new generation of Wireless Aquos will be ready next year with a more advanced wireless transmission technology. But for now, at a suggested retail price of $1,799, it seems expensive and underpowered.

By next year, Sharp will be up against the 800-pound gorilla in this business, Sony. Its LocationFree TV should hit U.S. stores in a few months and will boast several advantages over the Wireless Aquos. The smaller 12-inch screen only weighs about 5 lbs. It works in three wireless modes, including 802.11g, which, in a recent demo, let the signal travel about 100 feet. (We were unable to try it in a real home.) And the screen doubles as an Internet terminal with a touch-panel that you can control with either your finger, a stylus, or an on-screen QWERTY keyboard. Because it has a much richer feature set than the Wireless Aquos, Sony's $1,500 device may also be a bigger pain to set up.

It looks handy, but there's too little power for too much money

But the worst thing about wireless TV—or maybe for some folks it's the best—is the sheer decadence. I took the screen onto my back deck to catch Tour de France highlights one night with my sons. I felt guilty, and it wasn't a good, guilty pleasure. There was something unnerving about switching channels while birds chirped in a nearby tree. After a few weeks, I realized that I like to watch TV on the couch in my living room—and guess what? I already have a TV there. It has an inviting 30-inch screen, the picture is always crystal clear, and the power never cuts out. Maybe there's some life left in the wire and cord business. ■

BusinessWeek online Stephen H. Wildstrom is on vacation. For a collection of past columns and online-only reviews, go to Technology & You at www.businessweek.com/technology/

BY GLENN HUBBARD

Let's Put the 'Litigation Tax' on Trial

In a season of talk about tax cuts, there is a major one we could enact tha would boost our prospects for economic growth without adding to the deficit. This reduction would also improve the fairness of the nation's tax burden. I'm talking about the "litigation tax"—the tax on our economy from an inefficient tort system. Recently proposed federal legislation to reform class actions has been described as a battle between "trial lawyers" and "business." The truth is more complicated—and troubling. Tort reform is about cutting the litigation tax, which is large and affects millions of us, not just a handful of corporate defendants. Indeed, businesspeople and consumers on both the Right and the Left have recognized the benefits of tort reform.

President Bush's Council of Economic Advisers estimated in 2002 that the U.S. tort system's direct costs total about $180 billion a year. This is likely a conservative estimate: It ignores the many economic distortions that arise as individuals and companies try to avoid lawsuits. Examples include defensive medicine and decisions by manufacturers to remove products from the market. The estimate also ignores the potential adverse effect of excessive tort claims on innovation in industries ranging from general aviation to chemicals to pharmaceuticals and medical practice.

How much of that $180 billion in tort costs is "excessive"? As a simple guide, only 20¢ of each dollar of tort cost is paid to victims, and that share has fallen since the late 1980s. Of course, some administrative costs are required. But, even taking administrative costs into consideration, the CEA estimated that at least half of the tort cost is excessive. Other leading industrial nations have tort costs half those in the U.S.

FROM AN ECONOMIC PERSPECTIVE, tort costs are a pure burden on companies—a cost with no corresponding benefit. That's because punitive damages are random and fail to provide incentives to companies, many empirical researchers in law and economics have concluded.

Whatever estimates of the dollar amount one chooses, the total economic cost of the U.S. tort system is higher still. An additional "deadweight loss" arises because these costs distort decisions by producers, who generate less innovation because of high litigation outlays and by consumers who pay higher prices for goods and services because of embedded litigation costs.

In this political season much is being said about the distribution of tax burdens. Who pays the "litigation tax"? While the cost may be collected from a company, its burden is ultimately borne by workers who lose jobs or see their wages go down, by consumers who pay higher prices, by landowners who experience a decline in property values, a by investors via lower profits and share prices.

Assessing the true economic burden of a tax requires analyzing how wages and prices are adjusted throughout t economy as a result of it. While the legal burden of litigati costs falls directly on companies engaged in the productio and sale of goods and services, overall litigation costs act more like corporate income tax, which has a broader economic impact. Much of this corporate tax is shifted to consumers through higher prices or to workers if wages decline because of lower demand for the goods whose pric rise with the added costs. The remainder falls on investors

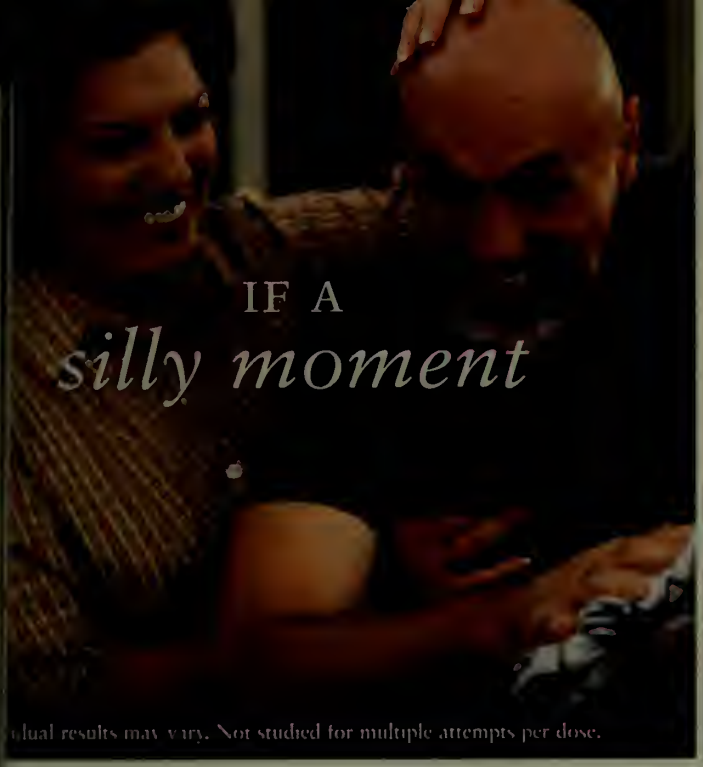
Tort costs should be counted as a tax that hits more than companies

This "litigation tax" has an impact on owners of all capital, just those companies most likel fall prey to tort litigation. Why? When litigation costs make investing in high-tort-cost secto less attractive, capital will flow t other sectors, driving down the of return in those sectors, too.

The burden on the economy i large. According to the CEA, if it were borne just by workers, litigation costs would be equival to 2.1% of wages and salaries. If "tax" were borne by consumers, it would be equivalent to a tax on income from savings of 3.1%. And less conservative estimates of the litigation tax lead to a larger equivalent ta burden on American workers, consumers, and investors.

In the election campaign this fall, we will no doubt hear lot about tax policy. But the sheer size of the litigation tax makes it an equally important topic as we debate America's competitiveness. A question for the Presidential candidates Do you support the class-action reform being considered b Congress as a way to reduce the "litigation tax"? ■

Glenn Hubbard *is dean of Columbia Business School. He chair the Council of Economic Advisers from February, 2001, to Marc 2003, and is an informal adviser to the Bush Administration.*



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In clinical trials, Cialis was shown to improve, up to 36 hours after dosing, the ability of men with ED to have a single ccessful intercourse attempt.

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Patient Information

Read the Patient Information about CIALIS before you start taking it and again each time you get a refill. There may be new information. You may also find it helpful to share this information with your partner. This leaflet does not take the place of talking with your doctor. You and your doctor should talk about CIALIS when you start taking it and at regular checkups. If you do not understand the information, or have questions, talk with your doctor or pharmacist.

What important information should you know about CIALIS?

CIALIS can cause your blood pressure to drop suddenly to an unsafe level if it is taken with certain other medicines. You could get dizzy, faint, or have a heart attack or stroke.

Do not take CIALIS if you:

- **take any medicines called "nitrates."**
- **use recreational drugs called "poppers" like amyl nitrate and butyl nitrate.**
- **take medicines called alpha blockers, other than Flomax® (tamsulosin HCl) 0.4 mg daily.**

(See "Who should not take CIALIS?")

Tell all your healthcare providers that you take CIALIS. If you need emergency medical care for a heart problem, it will be important for your healthcare provider to know when you last took CIALIS.

After taking a single tablet, some of the active ingredient of CIALIS remains in your body for more than 2 days. The active ingredient can remain longer if you have problems with your kidneys or liver, or you are taking certain other medications (see "Can other medications affect CIALIS?").

What is CIALIS?

CIALIS is a prescription medicine taken by mouth for the treatment of erectile dysfunction (ED) in men.

ED is a condition where the penis does not harden and expand when a man is sexually excited, or when he cannot keep an erection. A man who has trouble getting or keeping an erection should see his doctor for help if the condition bothers him. CIALIS may help a man with ED get and keep an erection when he is sexually excited.

CIALIS does not:

- cure ED
- increase a man's sexual desire
- protect a man or his partner from sexually transmitted diseases, including HIV. Speak to your doctor about ways to guard against sexually transmitted diseases.
- serve as a male form of birth control

CIALIS is only for men with ED. CIALIS is not for women or children. CIALIS must be used only under a doctor's care.

How does CIALIS work?

When a man is sexually stimulated, his body's normal physical response is to increase blood flow to his penis. This results in an erection. CIALIS helps increase blood flow to the penis and may help men with ED get and keep an erection satisfactory for sexual activity. Once a man has completed sexual activity, blood flow to his penis decreases, and his erection goes away.

Who can take CIALIS?

Talk to your doctor to decide if CIALIS is right for you.

CIALIS has been shown to be effective in men over the age of 18 years who have erectile dysfunction, including men with diabetes or who have undergone prostatectomy.

Who should not take CIALIS?

Do **not** take CIALIS if you:

- **take any medicines called "nitrates"** (See "What important information should you know about CIALIS?"). Nitrates are commonly used to treat angina. Angina is a symptom of heart disease and can cause pain in your chest, jaw, or down your arm.

  Medicines called nitrates include nitroglycerin that is found in tablets, sprays, ointments, pastes, or patches. Nitrates can also be found in other medicines such as isosorbide dinitrate or isosorbide mononitrate. Some recreational drugs called "poppers" also contain nitrates, such as amyl nitrate and butyl nitrate. Do not use CIALIS if you are using these drugs. Ask your doctor or pharmacist if you are not sure if any of your medicines are nitrates.
- **take medicines called "alpha blockers", other than Flomax® 0.4 mg daily.** Alpha blockers are sometimes prescribed for prostate problems or high blood pressure. If CIALIS is taken with alpha blockers other than Flomax® 0.4 mg daily, your blood pressure could suddenly drop to an unsafe level. You could get dizzy and faint.
- **you have been told by your healthcare provider to not have sexual activity because of health problems.** Sexual activity can put an extra strain on your heart, especially if your heart is already weak from a heart attack or heart disease.
- **are allergic to CIALIS or any of its ingredients.** The active ingredient in CIALIS is called tadalafil. See the end of this leaflet for a complete list of ingredients.

What should you discuss with your doctor before taking CIALIS?

Before taking CIALIS, tell your doctor about all your medical problems, including if you:

- **have heart problems** such as angina, heart failure, irregular heartbeats, or have had a heart attack. Ask your doctor if it is safe for you to have sexual activity.
- **have low blood pressure** or have high blood pressure that is not controlled
- **have had a stroke**
- **have liver problems**
- **have kidney problems or require dialysis**
- **have retinitis pigmentosa**, a rare genetic (runs in families) eye disease
- **have stomach ulcers**
- **have a bleeding problem**
- **have a deformed penis shape** or Peyronie's disease
- **have had an erection that lasted more than 4 hours**
- **have blood cell problems** such as sickle cell anemia, multiple myeloma, or leukemia

Can other medications affect CIALIS?

Tell your doctor about all the medicines you take including prescription and prescription medicines, vitamins, and herbal supplements. CIALIS and other medicine affect each other. Always check with your doctor before starting or stopping any med Especially tell your doctor if you take any of the following:

- medicines called nitrates (See "What important information should you know CIALIS?")
- medicines called alpha blockers. These include Hytrin® (terazosin HCl), Flo (tamsulosin HCl), Cardura® (doxazosin mesylate), Minipress® (prazosin HCl) or Urox (alfuzosin HCl).
- ritonavir (Norvir®) or indinavir (Crixivan®)
- ketoconazole or itraconazole (such as Nizoral® or Sporanox®)
- erythromycin
- other medicines or treatments for ED

How should you take CIALIS?

Take CIALIS exactly as your doctor prescribes. CIALIS comes in different doses (5 10 mg, and 20 mg). For most men, the recommended starting dose is 10 mg. **CIALIS s be taken no more than once a day.** Some men can only take a low dose of CIALIS bec of medical conditions or medicines they take. Your doctor will prescribe the dose that is for you.

- If you have kidney problems, your doctor may start you on a lower dose of CIALIS
- If you have kidney or liver problems or you are taking certain medications, your d may limit your highest dose of CIALIS to 10 mg and may also limit you to one tab 48 hours (2 days) or one tablet in 72 hours (3 days).

Take one CIALIS tablet before sexual activity. In some patients, the ability to have s activity was improved at 30 minutes after taking CIALIS when compared to a suga The ability to have sexual activity was improved up to 36 hours after taking CIALIS compared to a sugar pill. You and your doctor should consider this in deciding when should take CIALIS prior to sexual activity. Some form of sexual stimulation is needed f erection to happen with CIALIS. CIALIS may be taken with or without meals.

Do not change your dose of CIALIS without talking to your doctor. Your doctor may l your dose or raise your dose, depending on how your body reacts to CIALIS.

Do not drink alcohol to excess when taking CIALIS (for example, 5 glasses of win 5 shots of whiskey). When taken in excess, alcohol can increase your chances of ge a headache or getting dizzy, increasing your heart rate, or lowering your blood pressur

If you take too much CIALIS, call your doctor or emergency room right away.

What are the possible side effects of CIALIS?

The most common side effects with CIALIS are headache, indigestion, back pain, mu aches, flushing, and stuffy or runny nose. These side effects usually go away after a hours. Patients who get back pain and muscle aches usually get it 12 to 24 hours taking CIALIS. Back pain and muscle aches usually go away by themselves within 48 ho Call your doctor if you get a side effect that bothers you or one that will not go away.

CIALIS may uncommonly cause:

- **an erection that won't go away (priapism).** If you get an erection that lasts more 4 hours, get medical help right away. Priapism must be treated as soon as poss or lasting damage can happen to your penis including the inability to have erections
- vision changes, such as seeing a blue tinge to objects or having difficulty telling difference between the colors blue and green.

These are not all the side effects of CIALIS. For more information, ask your dc or pharmacist.

How should CIALIS be stored?

- Store CIALIS at room temperature between 59° and 86°F (15° and 30°C).
- **Keep CIALIS and all medicines out of the reach of children.**

General Information about CIALIS:

Medicines are sometimes prescribed for conditions other than those described in pat information leaflets. Do not use CIALIS for a condition for which it was not prescribed not give CIALIS to other people, even if they have the same symptoms that you have. It harm them.

This leaflet summarizes the most important information about CIALIS. If you wc like more information, talk with your healthcare provider. You can ask your doctor pharmacist for information about CIALIS that is written for health professionals.

For more information you can also visit www.cialis.com, or call 1-877-242-5471.

What are the ingredients of CIALIS?

Active Ingredient: tadalafil

Inactive Ingredients: croscarmellose sodium, hydroxypropyl cellulose, hypromell iron oxide, lactose monohydrate, magnesium stearate, microcrystalline cellulose, sod lauryl sulfate, talc, titanium dioxide, and triacetin.

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AMES C. COOPER & KATHLEEN MADIGAN

ıfter a June Snooze, Consumers Will Wake Up

ıher energy prices cut into spending, but fatter paychecks should fix that

U.S. ECONOMY Consumer spending has been the economy's main gine in recent years. Through recession and jobless recovery, useholds contributed more than their share of gross domestic ıduct to total economic growth. Then, quite suddenly last quarter, ısumers posted one of their weakest performances in more than a

accentuated by a sharp pullback in June. Was it just hole, or have households encountered a roadblock? ıe weight of the evidence so far strongly argues that umer spending will speed up again in coming ths. Confidence is high. Businesses are hiring. sehold income is growing. Interest rates remain low, mortgage rates actually down in recent weeks. So e sales are strong. And the energy-led inflation surge e first half will likely be transitory. Even Federal rve Chairman Alan Greenspan believes the softness ınsumer spending "should prove short-lived," as he Congress recently.

o be sure, jobs are the key to the consumer outlook. growth will have to continue to average about ,000 workers per month, as it did in the first half. ng at that rate will generate the income needed to t the fading stimulus from past tax cuts and last 's infusion of refinancing money. The good news is the available labor market indicators for July suggest lowdown from the first half's solid pace.

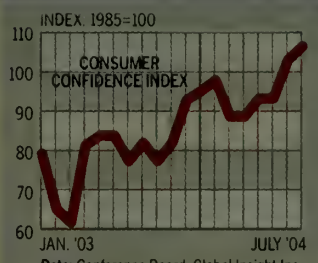
ven better, consumers will not have to contribute as h to growth in coming quarters as they have in ious years for the economy to perform well. Other ines are revving up, including capital spending, ntory building, and exports. This rotation from a sumer-led recovery to growth that is fueled by an easingly confident business sector is a classic iness cycle pattern that will keep the economy toring along at a healthy pace.

E SIGN THAT CONSUMERS are already shaking off ir spring doldrums comes from the Conference Board's sumer confidence index, which jumped in July for the ond consecutive month (chart). The index hit 106.1, the hest level in just over two years. Households' ratings of sent conditions remained about the same as in June, their expectations for the future rose sharply, despite h gas prices and the disappointing June employment ort released in early July.

In fact, consumers voiced increased optimism about job market. The percentage of households who rated s as plentiful rose to 19.8%, a two-year high. Although percentage is well below its prerecession levels, the improved confidence in the job outlook agrees with other positive July data, including jobless claims and various business surveys of hiring activity. Moreover, it runs counter to the June job report that showed only 112,000 new hires, suggesting that softness was a data fluke.

Consumer optimism in the job outlook goes hand in hand with increased business confidence. Earlier this month, the Conference Board reported that business confidence readings among chief executives in the first and second quarters were at their highest levels since before the recession. A second-quarter survey by PricewaterhouseCoopers shows executives in the factory sector are increasingly upbeat about prospects for revenues, capital spending, and hiring in the coming year. The PwC survey noted that the views of manufacturers had been trailing those in business generally, but that last quarter manufacturers turned "markedly more upbeat," matching the overall outlook of all large businesses.

CONSUMER SPIRITS TAKE FLIGHT



Data: Conference Board, Global Insight Inc.

WITH MORE COMPANIES now looking to hire, workers are seeing their pay rise at a rapid clip. Through May of this year, income from wages and salaries is growing at an annual rate of 7.2%, twice the 3.6% rate for all of 2003 before job growth took off. Owners of small proprietorships are also raking it in. Proprietors' incomes are growing at a 14.6% annual rate, up from last year's 8.6% pace. Taken together, those two categories make up almost two-thirds of household income. Even as aftertax income slows, as the effects of the tax cuts wear off, new jobs are generating before-tax pay at an accelerated pace.

More importantly, the gains in pay in the second half are not likely to be eroded by accelerating inflation. Bear in mind that the chief problem for consumers in the second quarter was the growing burden of higher energy costs that ate into buying power. From the end of 2003

through May, households shelled out an additional $47 billion for more expensive gasoline and other energy goods. That category is less than 3% of all consumer outlays, but the increase accounted for 22% of the total rise in consumer spending. Clearly, a lot of discretionary items went unbought, especially in low-to-middle-income households where necessities, like gas and heating oil, make up a larger share of monthly budgets.

By the end of July, though, the national average price of gas was down 16.5¢ per gallon, to $1.86, from its May peak of more than $2. In the second half, gas prices may well tick up again, especially with crude oil closing in on $43 per barrel on July 28. However, even if fuel prices match their high second-quarter levels, the contribution to overall inflation will be zero.

TAME INFLATION in the second half will also be a crucial determinant of interest rates. Rising rates will most likely dampen demand in the coming year, but if the Fed lifts them gradually, as seems possible, the adjustment will not be too painful. So far, despite the Fed's first rate hike—and an expected second one at its Aug. 10 policy meeting—interest-sensitive sectors, such as housing and autos, are holding up well.

With mortgage rates still around 6%, sales of existing homes soared to a record annual rate of 6.95 million in June, and June sales of new homes slipped only a tad, after surging 11.7% in May to a record 1.3 million (chart).

Meanwhile, auto demand has been whipsawed mostly by Detroit's incentive cycle. Financing deals pushed up sales of cars and light trucks in May to an annual rat 17.8 million, but a lack of deals caused sales in June t slump to just 15.4 million. Now, early reports from c dealers say a new round of incentives in July is spurr strong sales rebound. The June drop in car buying accounted for a big chunk of the quarter's overall spending slowdown. Stronger July sales w get third-quarter buy off to a strong start.

HOME SALES HOLD AT A HIGH LEVEL

Data: Commerce Dept., Global Insight Inc.

One wild card in tl consumer outlook is stock market, which sway confidence, wea and spending. Most recently, investors see dazed by all the uncertainty over the elections, possible terrorism, instability Iraq, plus recent weak-looking economic reports. The economic questions, at least, should be answered favorably in coming months, as better-looking data, especially on consumers, come to the forefront.

Indeed, it seems odd that concerns about the consu sector should crop up just when the most fundament supports to outlays—job growth and confidence—are starting to strengthen. And as businesses look more favorably toward the future, new investment and hiri will help to assure self-sustaining economic growth. ■

GLOBAL HOME PRICES

A Big Chill as Housing Cools?

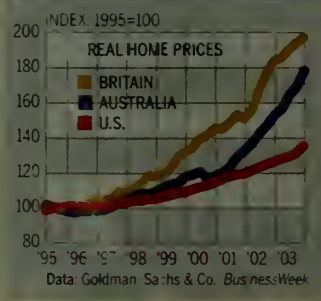
CENTRAL BANKERS in Australia, Britain, and the U.S. have voiced concerns about rising home prices. Economists from Goldman, Sachs & Co. have now determined how overvalued those prices are. But a drop in home values in those markets could help the global economy.

Real home prices in the three nations were undervalued in the mid-1990s but then soared—thanks to better fundamentals, such as demographics, rising incomes, low real and nominal interest rates, and the health of the nations' economies. The boost to consumers' wealth helped to lift demand.

The Goldman report calculates current home prices in the U.S., Britain, and Australia are overvalued by 10%, 15%, and 29%, respectively. A key reason for the runup was that, as mortgage rates fell, buyers could bid up prices without seeing any significant uptick in their monthly payments.

Now rates are rising, and history shows home prices adjust downward—often by too much, cutting into consumer demand. If long rates rise one percentage point and prices overshoot, the Goldman paper says the drag on U.S. spending would be 2.4%, British demand would slow 1.9%, and Aussie purchases could slip by 3.1%.

A GLOBAL JUMP IN HOME PRICES

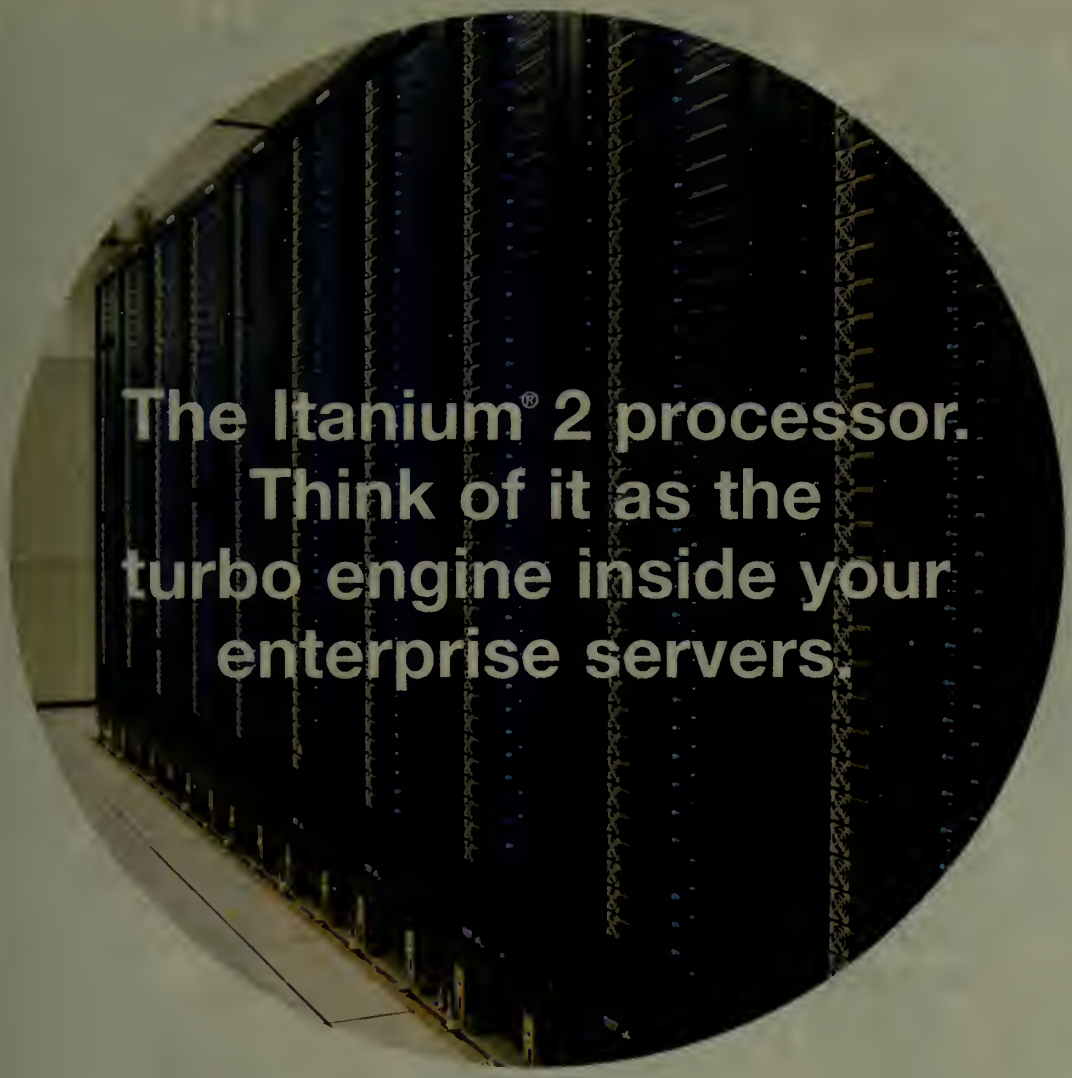


Data: Goldman Sachs & Co. BusinessWeek

On the plus side, notes the study, softer demand would help to rebalance the global economy away from excessive consumer spending, especially in the U.S. Bu there is a risk that demand could weaken too much at a time when some policymakers may not be abl offset the drag. The U.S. has little ammo left from fiscal or monetary policy. Britain could cut interest ra but its fiscal budget is in the red. O Australia has great flexibility becau it enjoys an almost-balanced budg and nearly neutral monetary polic

Bear in mind that soaring home prices are no longer an Anglo trend The study notes Spain, France, Italy the Netherlands, and Ireland have a seen big gains in home prices. Ever Japan, where real estate collapsed i the 1990s, prices have stabilized.

Clearly, though, the U.S., Britain or Australia will first face the challenge of allowing home prices adjust without disrupting the over economy. Their successes—or failures—will offer guidance for otl policymakers around the globe. ■



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ELECTION 2004

KERRY'S TOUGHEST CROWD

His challenge: Shaping a clear message that can win over a diverse group of holdouts

LONG AGO, A DEMOCRATIC Party known for internal knife fights perfected the art of the modern political convention—a seamless, stressless extravaganza that beams a message of Main Street centrism to TV viewers across the land. John Kerry's July 26-29 pageant in Boston was no exception, as speaker after speaker—from a sweatless Al Gore to a dialed-back Ted Kennedy—praised Kerry's mainstream values while avoiding red-meat rants against President George W. Bush.

But the Kerry show of harmony was more than an homage to a proven script. It also reflects the challenges ahead for the Democratic ticket of Kerry and John Edwards. With a nation evenly divided and the two party bases unified as never before, both Kerry and Bush have found it difficult to gain an enduring advantage. Although some convention-week polls showed Kerry up slightly, and some said Bush has regained his footing, neither candidate is anywhere close to breaking away. For Kerry, the stand-off is particularly frustrating given the string of bad news the President has faced over the past two months. Prior to his July 29 convention appearance, Kerry had not managed to capitalize on the Administration's agonies in Iraq and on an economy that appears to be sizzling statistically but still leaves many workers feeling left behind.

CONFLICTED VOTERS

EVERY SUCCESSFUL convention provides at least a temporary uptick for its star. But with a stunning 84% of voters already certain of whom they will back, Kerry has to expand his beachhead with fence-sitting voters to turn his bounce into a lasting shift. This slice of the electorate—ranging from 4% to 10% of likely voters—yearns for change but isn't sold on Kerry.

Who are these people? They are independents who, by 62% to 32%, say Bush doesn't deserve to be reelected, according

JENNIFER S. ALTMAN

GOING THE DISTANCE? Kerry must turn any convention bounce into a lasting shift

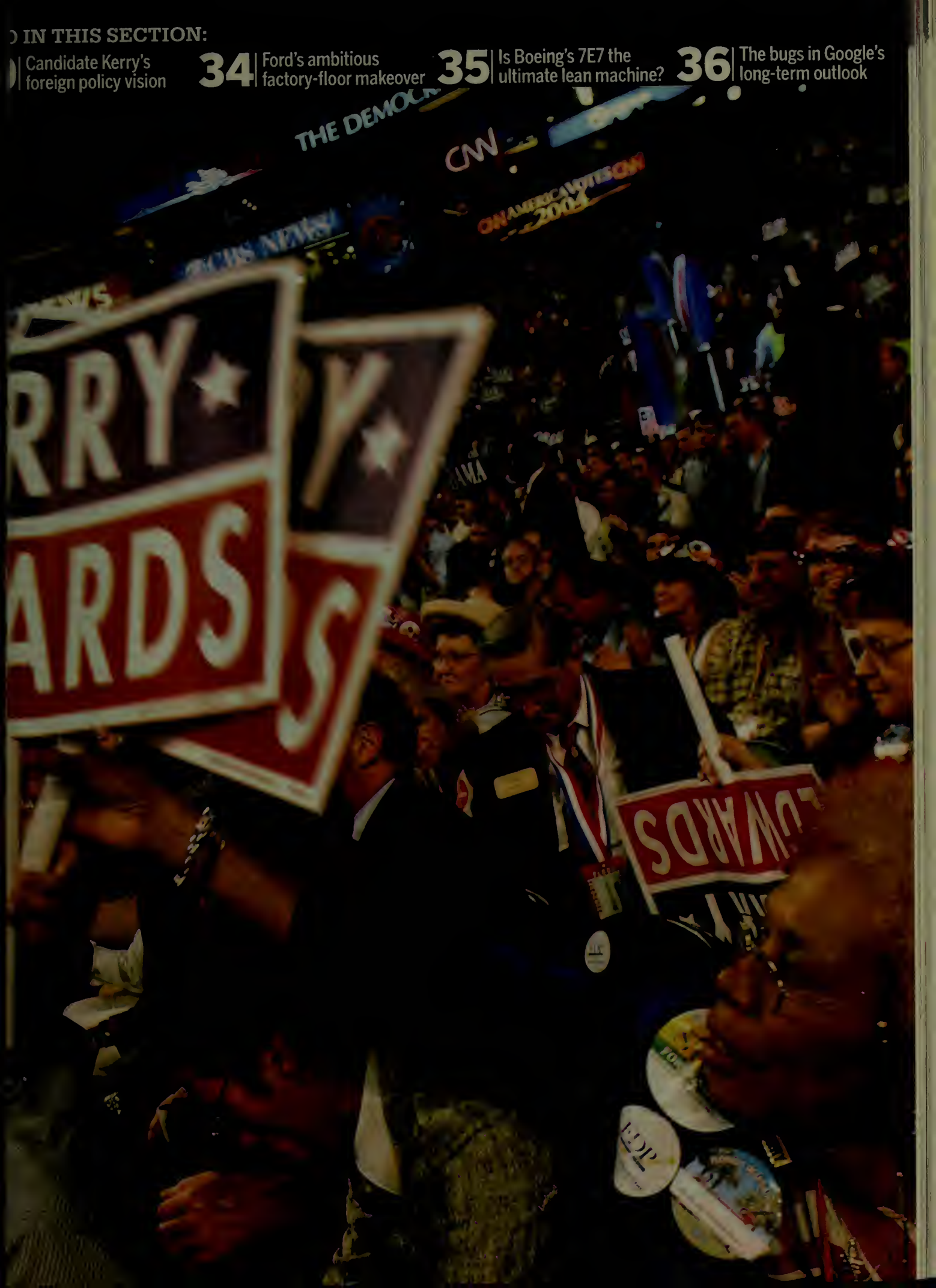
IN THIS SECTION:

Candidate Kerry's foreign policy vision

34 Ford's ambitious factory-floor makeover

35 Is Boeing's 7E7 the ultimate lean machine?

36 The bugs in Google's long-term outlook



to a July 19-21 Gallup Poll. They are upscale suburbanites who are turned off by Bush's ties to the Religious Right. They are also alienated blue-collar workers who feel left out of the GOP "ownership society." Finally, they are the turned-off young voters who worry about their job prospects. But the common thread running through these disparate groups is a deep dissatisfaction with the Iraq war. Just 34% of swing voters approve of Bush's handling of foreign policy, according to a July 7-18 survey by the Pew Research Center for the People & the Press.

To say these voters are conflicted is putting it mildly. Michael Woyach, 55, a family therapist in the Milwaukee suburbs, says he's upset over Iraq and Bush's "total disregard for reaching out and collaborating with other nations." But Kerry gives him shivers because "he flip-flops... And I'm concerned that he would be soft in the war on terrorism." He'll vote for whoever can "define an exit strategy from Iraq... and say what he's going to do to make the country more secure." Adds Michelle Starling, a 34-year-old administrative assistant in Arvada, Colo.: "I don't feel Bush has lived up to his promises. The country is not better economically, and there is more rancor. [But] I haven't heard Kerry give any reason why I should vote for him."

PRAGMATISM OVER PURITY

WITH INDEPENDENTS leaning his way, Kerry needs to reel in folks like Starling. Much will depend on his ability to give voters a clear sense of his positions on key issues, a task that he has so far struggled to accomplish. The Democrat sees a strong convention as just the beginning of a three-month drive to win the hearts and votes of the uncommitted.

Storming out of Boston, Kerry and Edwards plan a two-week blitz of electoral battlegrounds. Because the unified Democratic base is emphasizing pragmatism over ideological purity, Kerry has plenty of leeway to stress issues that will lure independents. In the stretch, he will focus on white-collar job security, health care, energy independence (page 29), and a return to a traditional foreign policy built around a beefed-up military and global alliances (page 30). While some of these items won't ring bells with liberal activists, Kerry senior strategist Tad Devine says: "We think this cluster of issues will be powerful with swing voters."

The challenge for Kerry is shaping a message that takes into account the diversity of the undecideds. Many blue-c independents, while embracing Ke tax-the-rich plans, identify with the on traditional family values. And many scale suburbanites who agree with Ke tolerant social views worry that his nomic policies could hurt growth.

WAR HERO Swing voters' dissatisfaction with the w could be Kerry's trump c

What's more, swing vo in different states have r cally different priorities Ohio, where the econ tops the list of concerns terrorism runs far beh Kerry is ahead, accordin Gallup. But in Flor where independents are more focused on terror Bush clings to a narrow l "It's hard to figure out message they can targe swing voters," says Gall Frank Newport.

Any exploration of wh riling swing voters is an ercise in cognitive dis nance. Grace Gillaspy, 5. Johnson & Johnson cons ant from the Philadelp suburbs, is a lifelong Rep lican who now leans Den ratic because she's up over Bush's "right-wing cial agenda." But she frets about Ke nomics. "Kerry is far too liberal. I'm for raising taxes on upper-income peo I hope to be upper-income some day."

The combination of a backlash agai Bush's Iraq policy and middle-class e nomic stress is opening a wedge betw the President and many undecided vot "I feel victimized," says Cuban-Ameri

BATTLING FOR SWING STATES Bush and Kerry are both at risk of losing

GORE IN 2000

WISCONSIN

The Badger State has gone Democratic four elections in a row but is increasingly competitive. Al Gore eked out a narrow win, and recent polls indicate a photo finish is possible in '04. Kerry's challenge: reverse the GOP trend in rural areas.

*Electoral votes

MICHIGAN

President Bush is unpopular in this industrial state hit hard by job losses, but Kerry hasn't been able to close the deal. He must woo upscale white-collar voters and break even among economically squeezed blue-collar whites in Detroit's suburbs.

IOWA

Gore barely edged Bush in the Hawkeye State, and the 2004 contest remains a dead heat. The key to victory: the farming areas outside Des Moines, which Bush narrowly carried in '00 —counties where Vice-Presidential nominee John Edwards ran strong in the caucuses.

NEW MEXICO

Think Florid the closest s 2000? Thin Al Gore won Mexico by ju votes, and the GOP is sper freely to turn that around; hopes to increase support Mexican-American voters. has to counter with messa aimed at voters angry ove

ndo Valdes, 51, a keting manager for a ht-forwarder in Mia- "Bush's policies are ing the middle class use of his war for Although he voted Bush in 2000, he'd p to Kerry if it wasn't worries about the ocrat's tax plan and acter. "I don't trust y," he says. "He's oting anything to get ted." To win Valdes , Kerry will have to e a convincing case he won't increase the of government or e his taxes.

ut that won't work everyone. To draw in r agonized voters, ry will insist that h's 2000 pitch for mpassionate conser- sm" was bait-and- tch marketing. This rge "goes to the heart swing voters' con- ns," says conservative tegist Frank I. Luntz. emocrats know exactly whom they're geting this year."

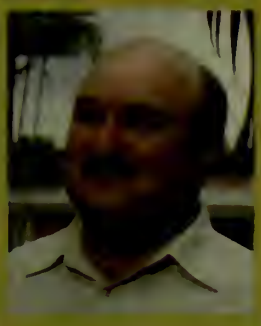
THREE INDEPENDENTS: THREE VOICES

He'll vote for whoever can "define an exit strategy from Iraq . . . and say what he's going to do to make the country more secure."

–Michael Woyach, 55
Family therapist, suburban Milwaukee

"Kerry is far too liberal. I'm not for raising taxes on upper-income people. I hope to be upper-income some day."

–Grace Gillaspy, 55
Consultant, suburban Philadelphia



"I feel victimized. Bush's policies are hurting the middle class because of his war for oil."

–Rolando Valdes, 51
Marketing manager, Miami

P 'GUNS OF AUGUST'

HE HOPES TO WIN in November, Bush st halt this erosion in the middle. Step e is a "guns of August" media blitz that l blanket contested states with ads ques- ning Kerry's character and what GOP airman Ed Gillespie calls the Democrat's treme makeover" in Boston. Step Two is rollout of a new agenda that hints at a ond-term vision. Among the elements: anded health-care access built around tax credits and private insurance; renewed talk about private Social Security investment accounts; a push for improved schools; and, possibly, pro-investment tax cuts billed as tax reform.

Bush will have gobs of money to trumpet his plan—with plenty left over to pulverize Kerry over values. As of June 30, his campaign had more than $60 million in cash to spend through the end of the GOP convention on Sept. 2. Then he is slated to receive $75 million in public funds for the general election.

Because federal law prohibits candidates who accept taxpayer subsidies from spending private money after their convention, Bush has an extra month to bash Kerry. To save his public money for the fall showdown, the Democrat won't advertise in an August stretch dominated by the Olympics and the GOP convention. "We are going dark," says campaign manager Mary Beth Cahill. "We know this is a risky move."

POLYGLOT GROUP

SOME OF THAT RISK will be shaved by aggressive anti-Bush ads funded by the Democratic National Committee and liberal "527" committees fueled by unlimited soft-money contributions. Key 527 field general Harold M. Ickes, chief of staff of America Coming Together, says that because Kerry "has not made the sale yet," the outside groups are targeting swing voters. They're also launching a huge get-out-the-vote effort among core Democrats. But the bifurcated approach is tricky, Ickes admits, because "we're dealing with a polyglot group with different agendas and different aspirations for Kerry."

The battle between the Bush campaign and Kerry's allies is likely to be harsh. "August is going to be nuclear war," says Democratic strategist Stanley B. Greenberg. That may not be good for either of the attackers: Swing voters are often alienated by negative campaigning. "Slowly but

arties captured in 2000. Here's where voters could switch sides in '04:

O

No Republican has been elected President without carrying Ohio, and polls show that ush is in big trouble in the uckeye State. His problem: agging unemployment that akes most voters pessimistic. He ust win swing voters in olumbus and Dayton.

NEW HAMPSHIRE

Bush edged Gore in the Granite State by 7,211 votes, but polls give Kerry a small but consistent edge this year. The Massachusetts senator is well-known and popular in neighboring New Hampshire, particularly in the high-tech suburbs just up the highway from Boston.

WEST VIRGINIA

Once a Democratic stronghold, the socially conservative state rejected Al Gore in 2000. But Kerry's war-hero status helps him among the many military families here. Bush needs to convince voters that Kerry doesn't share their family values.

NEVADA

This former GOP stronghold has been highly competitive since 1992. Demographic trends favor Democrats, particularly the growing Hispanic population and the influx from California. Las Vegas, the nation's fastest-growing metropolitan area, is key.

surely, these voters are saying 'I've had enough of it,'" says Dick Bennett, president of independent pollster American Research Group.

In their hearts, Kerry's liberal backers know what they want him to do: pull the U.S. out of Iraq rather than recruit 40,000 new troops; spend big on "human capital" programs rather than trying to trim the deficit; and be bolder in the bid to roll back Bush's tax cuts. But such is the hunger for sending Bush back to his ranch in Crawford, Tex., that the Democrats' normal ideological battle over priorities was completely absent from the Boston convention.

The upshot: Kerry has been given extraordinary leeway to shape his campaign message toward a sliver of undecided voters who share many values with the reigning Republicans. As long as K captures the White House on No Democratic partisans don't care how pulls it off. The party's new slogan: "V fight tomorrow." ■

–By Richard S. Dunham
Lee Walczak, with Paula Dwyer in Bo
and Ann Therese Palmer in Chic
Dave Lindorff in Philadelp
and Brian Grow in Atl

THE CANDIDATES

The Dems' Game Plan To Create a Two-Man Race

Jeffrey Cohn, a 31-year-old accountant and Ralph Nader fan, smiles as he implores shoppers streaming from a suburban Philadelphia Wal-Mart to sign his petition. An hour into the effort, Cohn has persuaded 20 people to back the move to get Nader on the Pennsylvania ballot as an independent Presidential candidate. But when the store's assistant manager objects, Cohn heads to another mall.

The scene is being repeated on sidewalks and parking lots across America as the Nader campaign scrambles to meet late-summer filing deadlines to get on some 33 state ballots. But Democrats are gearing up to fight back just as hard, fearing a repeat of 2000. Then, Nader siphoned enough votes from Al Gore in extremely tight races in Florida and New Hampshire to tip the election to George W. Bush.

This time, Democrats are leaving nothing to chance. In Pennsylvania, Dems are mounting a court challenge to Nader's petitions. Nationally, they've assigned Vermont Governor Howard Dean the task of persuading wayward Democrats that a vote for Nader is tantamount to a vote for Bush. Dean has declared "an extraordinary emergency" and his forces are packing some Nader events with protesters.

NADER He won't turn away GOP money or help

Democrats have already successfully knocked Nader off the ballot in Arizona on technicalities, and the party faithful are quietly fund-raising to support additional legal challenges in the battleground states of Florida, Michigan, West Virginia, and Nevada. "We can't afford to have Ralph Nader in the race," says Democratic National Committee Chairman Terry McAuliffe.

Republicans, on the other hand, have rallied to Nader's aid. Conservative groups, such as the antitax Citizens for a Sound Economy, helped collect ballot signatures i Oregon and Nevada. And the GOP collected 42,000 signatures to place Nader on the ballot in Michigan, where Kerry leads Bush by just two percentage points in a three-way race. For Republicans, the math is easy: Three of every four Nader votes are expectec to come from Kerry's hide. Meanwhile, Nader refuses to turn away Republican money or volunteers and has demanded that Kerry stop his party's efforts to exclude him from the race. "It shows the lack of confidence Democrats have in their own candidate," says Nader.

The GOP rally-'round-Nader has freed Democrats to be more open about their counter-ballot efforts, lessening the risk that they'll be tarred as anti-democratic. In Philadelphia, attorney Gregory Harvey is investigating reports that homeless people hired to collect signatures at $1 each have been forging names on Nader petitions. Under election rules, Harvey has just a week to compare computerized voter registration records to the 25,865 petitions Nader must submit by the Aug. 2 deadline. Nader forces calculate they'll need at least 40,000 signatures to survive a legal challenge, but admit they are behind in the attempt.

Given the challenges to Nader's ballot petitions and his decision to forego a place on the Green Party ticket, Nader is unlikely to receive the 2.88 million votes he won in 2000. But in a close race, a few thousand votes his way in key states could once again determine the winner. Reason enough for neither Democrats nor Republicans to take the Nader factor for granted. ■

–By Paul Magnusson in Levittown, Pa.

TOO CLOSE TO CALL
Nader could cost Kerry key swing states. Among the tightest races:

	MINNESOTA	NEW HAMPSHIRE	PENNSYLVANIA
BUSH	44%	43%	41%
KERRY	45	47	46
NADER	2	4	5

Data Mason-Dixon poll on July 14 of 625 likely voters margin of error +/- 4% University of Hampshire Granite State poll on July 20 of 459 likely voters margin of error +/- 4.5% Quinn University poll on July 12 of 1,577 likely voters margin of error +/

JOHN CAREY

Kerry's High-Wattage Energy Plan

hind the bluster lie solid ideas for easing U.S. dependence on foreign oil

JOHN KERRY'S BLUEPRINT for energy independence doesn't suffer from lack of ambition. In early August, he'll unveil an energy plan that he says can break America's addiction to foreign oil, revitalize the S. auto industry, help farmers and coal ners, fight global warming, and create os—all for just $2 billion per year. "We n live in an America that is energy dependent," Kerry promises.

Dream on. Americans burn 20 million barrels of oil a day, 11 lion of which are imported from the Middle East and elsere. And virtually every President since Richard M. Nixon talked about energy independence—but none has put ugh political muscle behind it to keep imports from rising. long as we depend on oil, we will depend on Middle East " says Fareed Mohamedi, chief economist at PFC Energy.

Yet strip out the over-the-top rhetoric, and Kerry's emerging n is both a good starting point and a welcome contrast to the sh Administration's focus on drilling for more oil. Kerry sets right goals: Significantly increase energy efficiency and use lternative fuels. And he uses tax incentives, rather than reg solely on regulations, to help meet those goals.

Any energy plan has to start with cars. In the Senate, Kerry sponsored a 2002 bill to raise fuelnomy standards to 36 miles per gal by 2015, up from the current fleet avge of 24 mpg. But higher standards unlikely to win votes in Michigan, a swing state. So Kerry's policy will of a carrot: tax incentives and federal llars to help Detroit develop and build gh-mileage cars, such as hybrids and vanced diesels. The goal is to help U.S. to makers pass the Japanese, who have lead in the hybrid market. Moreover, osting the average gas mileage of all S. vehicles to 36 mpg would save near2 million of those 11 million barrels of ported oil every day—and reduce carn dioxide emissions, which cause obal warming. If carmakers don't ree to move quickly, Kerry could pull t the stick: the threat of higher fuel-

NOT JUST HOT AIR
Boosting wind as a source of electricity

economy standards.

Kerry will also push for alternatives to oil. Replacing gasoline with ethanol made from corn and other biofuels made from crop waste can slash oil needs while helping farmers and slowing climate change. And the senator is setting a goal of getting 20% of America's electricity from wind, solar, biomass, geothermal, and other renewable sources by 2020, up from the current level of about 2% (not including hydropower).

The plan doesn't stop there. Kerry would work to increase supplies of natural gas by pushing for a pipeline from Alaska and for new ports where liquefied natural gas (LNG) can be unloaded. He'll support use of coal—the most abundant fuel in America—by promoting efforts to burn it more cleanly.

Intending to lead by example, Kerry vows to cut the government's own energy bill by 20% in 10 years—and to raise efficiency standards for everything from appliances to buildings. "The trick is to make oil less important to the economy," says a member of the Kerry energy team. Efficiency gains mean that energy costs will take a smaller bite out of the economy, so business and consumers will be more insulated from instability in the Persian Gulf and from future price spikes.

Kerry's call for energy independence just might resonate with voters in November. Democratic polls show that a majority of Americans believe the Iraq war proves the country needs to become less dependent on the Middle East. "Fairly or unfairly, the Iraq war has created a window to talk about energy," says Joseph Romm, a former Energy Dept. official. Bush supporters will argue that the President also talks about energy independence and new technologies. But Kerry's plan has a better chance of making America more energy-efficient than any effort we've seen from the two oilmen in the White House. More important, it could make a real difference to America's future. ■

ENERGIZING KERRY

Will his push to promote energy independence give Kerry's campaign a boost? The plan:

- Offer incentives for alternative fuels like farmer-friendly bio diesel
- Increase supply of natural gas, thereby helping utilities, consumers, and industry
- Use regulations and incentives to help Detroit create cutting-edge, high-mileage cars
- Boost energy efficiency broadly, in factories, buildings, and even appliances

ELECTION 2004

FOREIGN POLICY: A PEEK AT KERRY'S PLAYBOOK

His goals are not radically different from Bush's, but his plans for achieving them are

WHEN SENATOR John Kerry and Richard C. Holbrooke chat about foreign policy, Iraq and Afghanistan predictably top the agenda. But Holbrooke, an investment banker, ex-diplomat, and now a Kerry adviser, says their talk often turns to another topic that is seared into their consciousness: Vietnam. In the 1960s, Kerry was a young U.S. Navy officer there, and Holbrooke was a rising star in the Foreign Service posted to Saigon. The conflict was a crucible that forged both men's worldviews—an experience that can't help but color Kerry's foreign policy if he wins in November. "It's not that he's imprisoned by Vietnam," Holbrooke says. "He's informed by his experience there."

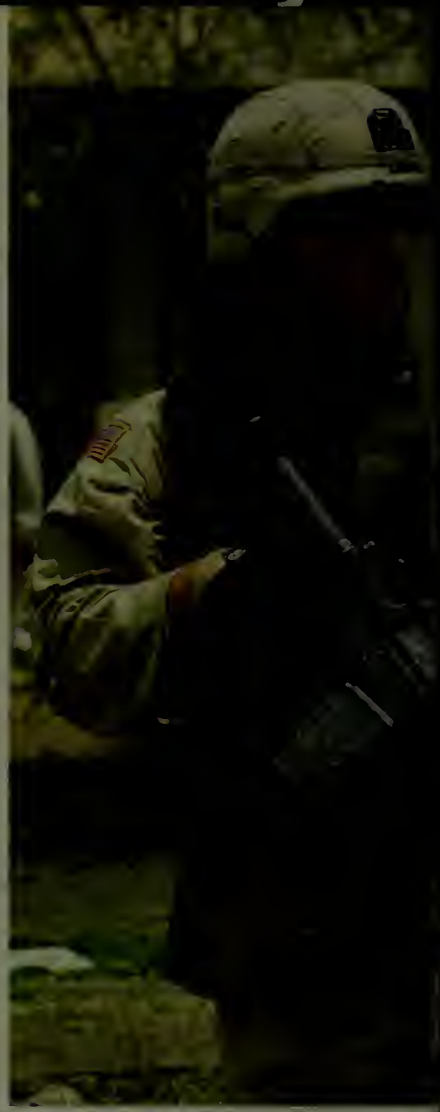
What did Kerry take away from his perilous stints patrolling the Mekong Delta—and the years since? He learned that Washington often doesn't know enough about countries where it intervenes, and thus overestimates what it can achieve. Vietnam taught Kerry that the U.S. should exhaust diplomatic options before resorting to war. And when the U.S. does use force, Kerry learned, it can't cut and run. If America abandons a dependent nation, "you have to count on mass instability," says Kerry biographer Douglas Brinkley. Vietnam also taught the candidate that issues can seldom be painted in black and white, as President George W. Bush often does: Just as Kerry served in Vietnam despite his doubts about that war, today he can back the war in Iraq while criticizing its management.

Can a complex global outlook win over voters in a post-September 11 America that fears an election-season attack? Kerry sells himself as a pragmatic internationalist pitted against a reckless, ideologically driven unilateralist. Republicans counter that with his back-to-the-future multilateralism and frequent waffling, Kerry isn't tough enough to win the war on terror, beat back Iraqi insurgents, and bring such rogue nations as North Korea and Iran to heel. Kerry's response: At the Democratic convention, he enlisted a dozen three- and four-star admirals and generals who back his candidacy. While voters still give Bush higher marks on terror, pollster John Zogby says undecided voters may choose Kerry's nuance over Bush's moralism. "Swing voters appear to be more in that column," Zogby says.

Kerry maintains that his approach is the best way to restore America's standing in the world and win greater global cooperation. That's needed on a host of fronts, from intelligence-sharing to tracking and freezing terrorists' assets. "It will take new leadership from the U.S. to change the credibility of our government and its ability to bring people to the table," Kerry told *BusinessWeek*. To start the process, a newly inaugurated President Kerry would make a quick trip to the U.N., meet with European leaders, and launch an intensive Middle East peace initiative.

> "It will take new leadership... to change the credibility of our government"

Many believe a Kerry win would yield a global sigh of relief. Bush's "religious [attitude] of good and evil, you're with us or against us—this is alienating even many conservatives in Europe," says Karsten D. Voigt, coordinator of German-Americ cooperation at the German Foreign M istry. China and other countries in A "consider Bush's policies too dangerc and simple," says Wang Yong, a global lations expert at Beijing University.



A MORE NUANC APPROACH

Billing himself as a pragmati Kerry says he won't let ideolo dictate foreign policy. His approach to key flash points:

GET NATO TO PITCH IN

BUT WHILE THE TONE may be differe the Kerry Doctrine's substance may mark the radical departure from Bu policies that many expect. One reas Bush has coopted policies Kerry has vocated, from expanding the U.N.'s role Iraq reconstruction to negotiating w North Korea to pledging to impleme

BAGHDAD Politically, Europe may be in a better position to help if Kerry is in charge

RAQ WAR
ys he'll send more troops
d. He hopes to persuade
peans to commit
and money. To help do
/ favors the appointment
High Commissioner
who would oversee
s and reconstruction.

NORTH KOREAN NUKES
Without giving up on the Six-Party Talks to end North Korea's nuclear program, Kerry would also initiate direct meetings with Pyongyang. That, he believes, would quickly test whether North Korea is serious about giving up any nukes it has.

MIDEAST PEACE
Kerry would renew the Israeli-Palestinian peace process, appointing a special envoy and investing his own time. To get the rest of the region on board, he would not push for rapid democratic reforms in the Arab world, as Bush has done.

e 9/11 Commission's recommenda-
ns. What's more, Kerry is more hawk-
than many Democrats and won't rule
t a Bush-style preemptive strike or uni-
eral military action if allies balk at join-
g a coalition. Europeans "are in for a
sappointment," says Ezra Suleiman, di-
ctor of European studies at Princeton
niversity. "They think there will be a
ick turnaround on policy, and there
on't." Adds Kerry adviser James P. Ru-
n: "The goals of foreign policy don't
ange that much from Administration to
dministration. The difference—and it's a
g difference—is how you go about
hieving those goals."

Take Iraq. Like Bush, the Massachusetts Democrat would stay the course. But he would make adjustments. While Bush has sought more U.N. involvement, Kerry wants a U.N. High Commissioner to run Iraq's elections and reconstruction. And he would invite Iraq's neighbors to a summit to pledge to protect Iraq's borders and stop meddling in Baghdad's internal political affairs.

Kerry also wants NATO troops to relieve the stress on American GIs. He believes allies have the resources but don't want to share them with this White House. "There's a political cost [foreign] leaders must pay" when they cooperate with Bush, says Rubin. "If Kerry is elected, that calculation is going to change." But will it change enough to get boots on the ground?

In a similar fashion, Kerry would preserve the Six-Party Talks for dealing with North Korea's nuclear program but would tweak the U.S. approach. Again, though, Kerry will have to contend with Bush's sudden policy shifts. Under pressure from China, Japan, and South Korea, which were tired of U.S. stonewalling, the President recently outlined for the North what it could gain by ending its nuclear capabilities—a step Kerry had urged for months. And U.S. officials have had some tête-à-têtes with North Korean officials, a previous no-no. Kerry would hold formal direct meetings with Pyongyang. Some Kerry aides, skeptical that strongman Kim Jong Il would give up his nuclear program, think such talks could flush out his real intentions.

AN OPENING IN THE POLLS

BOTH CANDIDATES demand verifiable dismantling of nuclear facilities. But Kerry goes further. He might put a top adviser in charge, such as former Defense Secretary William J. Perry. The hawkish Perry "is no softie on North Korea," says Richard H. Solomon, president of the U.S. Institute of Peace. The Kerry team would state clearly that certain steps, such as building nuclear bombs, would trigger an economic or even military response from the U.S. Bush hasn't been so explicit.

In the Middle East, Kerry would make a renewed effort to push the peace process forward. He would appoint a Presidential envoy to reinvigorate the process and work with the Palestinian Authority and neighboring states to create a Palestinian leadership "that in fact can deliver across the table for the Israeli government," says Rand Beers, a counterterrorism expert who left Bush's National Security Council to coordinate

the Kerry campaign's foreign policy.

How will all this play with voters? Bush's mixed record creates an opening. A July 19-21 *Wall Street Journal*/NBC News poll shows that by 50% to 47%, Americans believe the Iraq war was a mistake. Yet so far, Kerry has made little headway: Only 36% in the *Wall Street Journal*/NBC News poll rated him highly on protecting U.S. interests abroad. And a July 19 USA *Today*/CNN/Gallup poll shows Bush with a 56%-to-38% edge on handling terrorism.

Nor will Kerry's approach necessarily bring détente with Europe. Walter Russell Mead, a senior fellow at the Council on Foreign Relations, says that as Europe becomes more unified, it sees itself as a rising great power, while the U.S. sees it as declining. "Those tensions will be pre regardless of who wins in November, says. The issue for voters is whether t want a President who sees the worl black and white or in shades of gray.

–By Stan Crock in Washing with Jack Ewing in Frankf John Rossant in Paris, Moon Ihlwa Seoul, and Dexter Roberts in Bei

ELECTION 2004

'I'll Restore America's Reputation'

IS THE WORLD READY FOR the Kerry Doctrine? Democratic standard-bearer John Kerry thinks so. In a July 16 talk with *BusinessWeek* Editor-in-Chief Stephen B. Shepard, Washington Bureau Chief Lee Walczak, and Washington Outlook Editor Richard S. Dunham, the Massachusetts senator outlined his vision for a foreign policy based on renewing traditional global alliances.

What will a Kerry Presidency mean for the war in Iraq?

It will take new leadership from the U.S. to change the credibility of our government and its ability to bring people to the table. I have a plan—which I'm not going to negotiate in public. I am not going to play my hand. But I am convinced I can bring Arab and European countries to recognize the global interest we have in [preventing] Iraq from becoming a failed state.

I will begin in a different place than this Administration. I'm prepared to share responsibility for decision-making in reconstruction and other [things]. That is the prerequisite for bringing other parties to the table.

But won't the French and Germans continue to have issues with U.S. global power?

The French will be the French and the Germans the Germans, and I know them well. But I am convinced that leadership, properly shared, can reestablish alliances that have served us well over the last century. These people understand the stakes. They have a deep resentment of a unilateral arrogance that has made it very difficult for people to do what is doable.

KERRY "We are viewed as somewhat isolated"

Still, does the halting response of the global community [toward Iraq and Iran] give you pause about the limits of multilateralism?

Absent U.S. leadership, multilateralism often has its limits. If the world saw a different tone and a different kind of relationship between us and other countries, people would have different reactions. We are viewed as somewhat isolated.

How would you change American foreign policy, in broad terms?

I would approach North Korea differ ently [with direct negotiations]. would approach global warming dif ferently. Now, I am not one who be lieves that the Kyoto treaty [on global warming] should have been ratified—it was flawed. But I am one who believes in going back to the table to fix it. With Russia, we can do a better job [containing] loose nuclear materials [Other areas include more help for AIDS in Africa, the Africa Growth Development Act.

There are a series of things we could do quickly that would change the at mospherics to say to people, "Hey, they get it." Then goodwill begins to grow. This President has used up the bank and doesn't have much to draw on. And our country is hurt because of that.

Could this new era of good feelings affect the business climate, as well?

I want American businesspeople to travel around the world without bodyguards. I'd like them to be able to go to another country and compete without prejudice. I'd like U.S. athletes to be able to go to [the Olympics in] Greece and not be told, "Don't wrap yourself in the flag. No demonstrations of patriotism."

I'm a person who traveled for 40 years, and I know what it was like when you would go into a bar and people would pat you on the back and buy you a drink because you were American. Now, they would kick you out and want to kill you. I'll restore America's reputation, and I think that's primary in this race. ■

ADY TO ROLL
vision chief
ılally is upbeat

ROSPACE

A PLANE THAT COULD HANGE THE GAME

oeing's 7E7 will slash costs for carriers ıd take half the time to build

CUTTING COSTS HAS BEcome an obsession for major carriers worldwide. Nowhere is that more true than in the U.S., where big airlines closed out July with a second-rter loss of $2.1 billion, as they conıed to battle rising costs. While foreign riers tend to be in better shape, the inıtry knows the key to survival lies in ıg lean and mean.

f only carriers could get their hands on oeing 7E7 now. Experts say the plane, ich will go into service in 2008, could raw airline economics. Much has been d about the 7E7's fuel-sipping nature. t Boeing Co. is luring carriers with othpotential cost savings, too. And thanks more efficient factories, it aims to build h 7E7 in half the time it takes to crank t a widebody jet. That would get new nes to carriers faster when demand ges. "The 7E7 is a significant step forrd for the economics of a plane," says er Gardner, vice-president for techniissues at Cathay Pacific Airways Ltd.

While U.S. carriers are not in a position to buy new planes now, Continental, American, and Northwest have all shown interest in the 7E7. Meanwhile, foreign carriers have ordered 62 7E7s, and Boeing expects 200 more orders by yearend. And while strong defense sales helped the company post second-quarter income of $607 million on $13.1 billion in revenues, reversing a year-ago loss of $192 million, Boeing is hiking its 2005 earnings forecast thanks to renewed strength in its commercial business. Says Boeing Commercial Airplanes CEO Alan R. Mulally: "We feel good about where we're going."

So will Boeing deliver? Much depends on getting its new manufacturing process right. In the 1990s, Boeing ramped up hard after putting in place a supposedly more efficient system—with nearly catastrophic results.

This time, key suppliers believe Boeing will do better because it has been improving the work flow in its factories. "Nothing like a near-death experience to change bad habits," says Richard Aboulafia, an aerospace analyst at Teal Group. "Boeing's factories are more efficient than at any time in its history." Indeed, Boeing has cut the final assembly time of a 737 in half, to 11 days; Airbus has only been able to reduce its A320 final assembly from 40 days to 24.

With the 7E7, Boeing aims to work even faster. Suppliers will build huge chunks of the fuselage, which—in a break with the past—will be packed with plumbing, electrical systems, and computers before being shipped to Seattle for final assembly. By outsourcing more of the manufacturing, Boeing aims to build a 7E7—from start to finish—in four months, rather than the traditional 12. The strategy, though, carries logistical risk, since it relies heavily on suppliers. Still, most analysts believe Boeing has established a sufficiently strong relationship with its partners.

CHEAPER TO FLY

IF BOEING CAN BUILD its plane faster, carriers stand to benefit. Typically, by the time airlines take delivery of a new plane, they must reconfigure the interior because the market has changed. That's expensive: It once cost Cathay $1 million to shift a toilet three inches on one 747. "If you cut the delivery time in half, you can respond to market changes and avoid costly interior makeovers," says Gardner.

Carriers also like how the plane could help cut costs and lift revenues. The plane is expected to be 10% cheaper to operate. Its composite fuselage won't require checking for cracks, which costs $2 million to $4 million per plane for aluminum jets. And its 20% better fuel economy will allow airlines to carry cargo on longer flights, a potential revenue-booster.

Boeing still faces plenty of challenges. Airbus says it will respond with an improved or new A330, which will closely match the 7E7's operating costs. Boeing also will have to manage a whole new way of building planes. And with delivery three years off, airlines have time to see if Boeing can hit its performance goals. But if it does, the 7E7 could be the best news the industry has had in years. ■

–By Stanley Holmes in Seattle, with Michael Arndt in Chicago

THE STAT

200

Number of new 7E7 orders Boeing expects by the end of the year; so far the company has 62

AUTOS

HOW WOULD YOU LIKE YOUR FORD?

The pioneer of mass production turns its back on one-size-fits-all cars

ON AUG. 10, FORD MOtor Co. executives and local dignitaries will descend on an 80-year-old manufacturing plant on Chicago's South Side. As TV cameras roll and workers applaud, Ford's first new midsize cars will roll off the line. Why all the hoopla? Because a revolution is under way at Ford. The company is turning its back on the mass-manufacturing model pioneered by founder Henry Ford. The Chicago assembly plant, refurbished at a cost of $400 million, is capable of making as many as eight models on two different chassis. Ford's aim is to better meet rapidly changing consumer tastes in a fragmented car market.

While industry experts say the new strategy is long overdue, it's a challenge for Ford to pull off so much at once. Combining the flexible-manufacturing revamp, a new $250 million supplier park next door, a $150 million overhaul of the adjacent stamping plant, all on top of launching three vehicles, will require a serious juggling act. "It's complicated because you've got all these different things coming together," says North America product creation chief Philip R. Martens.

Whether Ford can run its new system profitably—and at full tilt—will depend on the new cars' popularity. Too bad then that the early buzz on the Ford Five Hundred and Mercury Montego sedans and Ford Freestyle sport wagon is lukewarm. Word is that the cars suffer from meager power and style.

BLAND TRIO

FORTUNATELY FOR FORD, the new plant can quickly switch to building more popular autos if one or more of its new models falters. That's all part of Chief Executive William C. Ford Jr.'s vision of a 21st century manufacturing complex. The plan: flexible factories with lean inventories and just-in-time parts deliveries—the kind the Japanese have been perfecting for the past decade.

To help make it happen, Ford persuaded 11 major component makers to set up shop on their own campus near the plant. Their proximity streamlines the flow of components to Ford's assembly line and cuts transportation costs. Lear Corp., for example, will go from shipping assembled interior ceilings from 350 miles a to a mere half mile.

Shortening the pipeline means I can cut parts inventories from a one two-day supply to just eight hours, sav big bucks. The proximity also lets e neers shuttle back and forth to fix glitc at the supplier plant. Says Lou Salvat head of Lear's Ford business: "If you pull it off, like Ford is doing in Chic it's beneficial for suppliers as well as the manufacturers."

Still, a supplier industry watcher some Chicago component makers nervous. They had to invest heavily build plants dedicated to supply Chicago factory, tying their returns t car whose success is uncertain.

It doesn't help that the three new c are generating yawns. Sure, the c based on chasis made by partner Vo get high marks for smooth handli comfortable ride, and roomy, easily configured interiors. Yet their he weight makes them feel sluggish, those who have driven the cars. F takes issue with the characterizati "We deliver better acceleration, be fuel economy, and half the emissions some of our competitors," says a com ny spokesman.

Still, at a time when Chrysler Grou wowing buyers with its brashly styl 300C sedan, Ford is bringing out a c of bland cars. Ford execs point out t the Honda Accord and Toyota Can both top rivals, aren't exactly sexy. I they are well-established contenders. lure buyers away from Accords or Ca rys, says Wesley R. Brown, an analyst consultants Iceology, "you have to something extraordinary."

Ford has gone to great lengths to p off its manufacturing transformation Chicago. The ultimate payoff will hin on how buyers judge the new cars. ■

–By Kathleen Kerwin in Detr

THE FREESTYLE

THE FIVE HUNDRED

Brave New Wheels

The strategies behind Ford's new midsize cars

MIX AND MATCH

The company's manufacturing plant in Chicago is now capable of shifting production from one model to another as demand changes.

SUPPLIERS NEXT DOOR

To streamline the delivery of parts, 11 big component makers have set up shop near the Chicago plant. That will help Ford cut inventories to an eight-hour supply.

LESS IS MORE

Ford is abandoning its mass-market model and is producing fewer units of individual vehicles—to better serve the fragmented U.S. market.

FROM THE DEPTHS
Greece's synchronized swimming team

LYMPICS

NBC'S MARATHON OF COVERAGE

Will viewers have the stamina to stay tuned for more than 1,200 hours of Games?

SPORTS FANS, STRAP yourselves in for the telecast of a lifetime—or, at least, the longest one. On Aug. 11, the Greece-U.S. women's soccer match will kick off the Summer Games in Athens. It will also mark the start of NBC Universal's huge Olympics bet. The soccer game, airing on MSNBC, will be the first of an unprecedented 1,200 hours of coverage over 17 days, the longest continuous telecast of a sporting event in TV history. Spread over seven channels, NBC will offer more programming than the past five summer Olympics combined. And for the first time, all 28 Olympic sports will air on TV, even badminton and synchronized swimming.

Although a windfall for fans of such offbeat sports, not to mention insomniacs, the marathon coverage comes with big risks. Will the General Electric Co. unit be able to make back the $793 million it spent for the U.S. rights to broadcast the Athens Games? Just as crucial, the Olympics coverage is serving as a sort of test bed for integrating NBC's broadcast and cable outlets with Universal's TV and movie businesses following their merger in a $14 billion deal in May. Indeed, a rationale for the deal was the opportunity it offered to provide programming and promote other shows across a swath of broadcast, cable, and even Internet platforms.

Yet in a media-saturated age in which sports scores are available at the click of a mouse and the 100-meter dash outlasts some attention spans, around-the-clock coverage could sorely challenge the sports-watching stamina of viewers. It could also threaten what has been the golden goose for NBC, the Games on prime time. Randy Falco, president of the NBC Universal Television Networks Group, insists viewers will want it all. "There will be an added excitement to the Games," he says, "because it will feel like they are ever-present." But TV consultant Jim Spence wonders where the tipping point is: "There's no way people are going to be able to watch all that" Olympics coverage.

With the flood of programming, how does NBC hope to turn a profit? Mostly the same way it always has: on sales of prime-time ads on the broadcast network, which have nearly sold out at about $730,000 per 30-second spot.

But selling the ad time is only half the battle—NBC still has to deliver ratings. And the network faces a greater risk than ever of disappointing marketers. Splintered among seven different NBC Universal TV channels—NBC, MSNBC, CNBC, USA Network, Bravo, Telemundo, and a high-definition channel—the Olympic audience may no longer add up to the solid base advertisers value.

In 2000, in Sydney, ratings dropped well short of the 20 million prime-time viewers NBC had promised advertisers, forcing the network to provide free commercial time to compensate. Even so, Morgan Stanley estimates that NBC still managed a $50 million profit on the Sydney Games after spending $705 million on the rights. That's the best way to make GE brass happy, since the company has agreed to pay $7 billion for the right to broadcast the Olympics, starting in 1992 and stretching to 2012.

NBC will deliver more than just TV coverage, too, now that it can send live Internet feeds and Olympics results right to cell phones. NBCOlympics.com will provide up-to-the-minute television schedules, breaking news, instantaneous results, and video highlights. But that could be risky, as well, if all the advanced technology dampens the anticipation and surprise that attract viewers to the prime-time broadcasts. Still, Andy Donchin, a media buyer at Carat USA, has faith in the lure of the Olympics: "There is only a handful of true events out there that can draw big ratings." And if the grand experiment works, and Athens delivers profits to NBC Universal, you can bet there will be a few new team handball fans at corporate headquarters. ■

–By Katie DeWitt in New York

THE STAT

Badminton at 3 a.m.? NBC hopes to recoup its $793 million investment by broadcasting more hours of coverage than were aired during the last five Summer Games combined

BusinessWeek online For a Q&A with NBC Universal Television Networks Group President Randy Falco, go to www.businessweek.com/magazine/extra.htm

COMMENTARY

BY BEN ELGIN

Google This: Investor Beware

The Web search outfit's business is terrific, but its long-term outlook is cloudy

WHEN GOOGLE INC. predicted a wallet-cleaning price range of $108 to $135 for its shares on July 26, few on Wall Street flinched. And why should they? Despite a valuation as high as $36 billion for its offering expected in August, the search kingpin's business continues to dazzle. Growth in sales and profits have rocketed over 100% so far this year. And analysts project Google will generate more than $350 million in 2004 net profits. Even with stepped-up competition, Google's share of the U.S. search market has grown five points in the past year, to 37%, giving it a comfortable 10-point lead over Yahoo! Inc., according to researcher comScore.

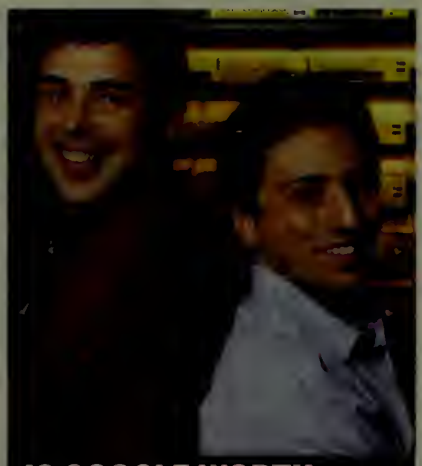
Sure, IPOs are inherently risky, but Google stock may be especially unwise at this nosebleed price range. At the midpoint price, Google's would-be $33 billion valuation is a step down from its closest competitor, Yahoo, a seasoned Internet giant with a diverse revenue stream and a market value of $40 billion. Compare projected 2005 earnings against these valuations, however, and Google's multiple is just a speck below Yahoo's. That's troubling, since Google is largely a one-trick pony, with no easy means to diversify its business and hefty management challenges. "It's priced for ultimate perfection," says a skeptical Google investor who plans on selling after the IPO.

Long-term investors should be very wary of Google's single-barrel business model. Selling ads that appear next to search results, or paid search, contributes over 80% of Google's sales. According to Forrester Research Inc., the U.S. search ad market grew 94% in 2003 to $1.9 billion, but growth is expected to slow from 45% in 2004 to 16% in 2007. As long as Google remains so heavily dependent on a single search market, it should trade at a discount to Yahoo, says American Technology Research Inc. analyst Mark S. Mahaney. Citing its quiet period, Google won't comment.

Google co-founders Sergey Brin and Larry Page aim to expand into new businesses, but that won't b easy. The most obvious foray would be into so-called bran marketing, the multimedia ads that adorn most Web sites. like the text-only ads that accompany Google's search resu these snazzier ads entice large advertisers that are as concer with building brand as they are with driving traffic to their si It's big business, worth about $4.5 billion in the U.S. this y according to Forrester, vs. $2.8 billion for search ads.

Google, however, is a long way from proving itself a playe branded marketing. Sure, the six-year-old company is tinker with a trial program that delivers targeted image ads from its r ter of 150,000 advertising customers to other online cont providers. But Google has not hinted at near-term plans to o up its own prime real estate for branded ads. Such a risky m would run contrary to Google's long-established mission of p viding a sleek, simple page that favors speed over sizzle.

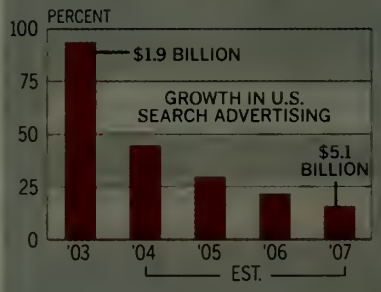
Even if Google does pull the trigger, it would desperat trail such rivals as Yahoo, Microsoft's MSN, and AOL, wh have spent years bu ing their salesforces a relationships with tra tional marketers. though Google point its 150,000-plus adv tisers, buyers of search ads often are the same people who buy branded a "The people who control these budg are very different," says Wenda H. M lard, chief sales officer at Yahoo.



AD DOGS Brin and Page will likely pursue "branded" ads

IS GOOGLE WORTH $36 BILLION?

Its main business is maturing quickly



Data: Forrester Research Inc.

Google's management structure co also be a concern. The company pri itself on an organization that is nea devoid of middle management and val freedom for engineers and their work. I Google's headcount is growing fas today than at any other time in its you life—adding 3.6 employees each day far this year, vs. 1.1 a day in 2002. Ba then, Google's vice-president f engineering, Wayne Rosing, fretted ab the risks facing Google as it raced p 500 employees. Google will be ha pressed to balance innovation and or as it approaches 3,000 employees la this year.

Google will no doubt lure plenty of terest when it sells shares, likely in Augu But given all the challenges ahead, sm investors will proceed with caution. ■

ITED BY MONICA ROMAN

EADLINER

RIAN ROBERTS

IOW, THAT'S 'AY TV

EO Brian Roberts on July 28 ad good news for Comcast areholders, who were upset arlier this year by his failed ostile $54 billion bid for Walt sney. Roberts announced e nation's No. 1 cable perator has authorized an dditional $1 billion to buy ack shares, bringing the otal to $2 billion. Roberts, 5, is betting the move will oost the price of Comcast hares, which have fallen 12% n July 28, to $27.56, since e Feb. 11 bid.

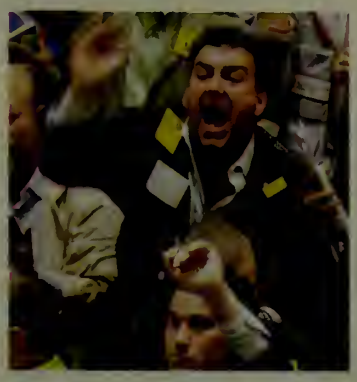
Yet some investors remain oncerned about Roberts' ependence on dealmaking o keep the Philadelphia able company growing. They vere spooked by the scuttled Disney deal and are wary of other possible acquisitions, ncluding bankrupt Adelphia Communications. Still, it's not as if Comcast needs deals to grow: On July 28, it reported Second-quarter operating ncome doubled from a year earlier, to $852 million. Roberts also raised Comcast's operating cash flow estimates for 2004 to $7.5 billion, an 18% jump over last year. That should cheer up shareholders a bit.

–Tom Lowry

TIME WARNER: SELF-SCRUTINY

Time Warner has launched an internal probe into accounting at AOL Europe covering a period in late 2000 when **America Online** struck a deal with **Goldman Sachs**. The arrangement was reached just before the merger between AOL and Time Warner closed. As first reported by *BusinessWeek*, AOL arranged for Goldman to buy 1% of AOL Europe to reduce AOL's ownership below 50% and ease competition concerns by Europe's antitrust czar (BW—June 28) about the Time Warner merger. But the deal also guaranteed a repurchase from Goldman at a preset price and date, which regulators may view as illegal asset-parking. AOL also may have violated securities laws by not disclosing the deal to investors. **The Securities & Exchange Commission** would not comment. Time Warner officials would not comment further. Goldman says it has done nothing wrong.

RUSSIA ROILS CRUDE OIL



Crude oil soared to a record $42.90 a barrel on the **New York Mercantile Exchange** on July 28 as Russia's biggest oil exporter warned that it might be forced by the Russian government to halt production. Lawyers for **Yukos** said the embattled company had been prohibited by the Justice Ministry from selling property. It has asked the ministry to clarify whether "property" includes its oil. The government of Russian President Vladimir Putin has been moving toward selling Yukos in pieces to settle a $3.4 billion bill for back taxes. Putin's critics say that he's trying to punish Yukos' politically ambitious former CEO, Mikhail Khodorkovsky. The company's latest warning might be a way to rally support.

KING OF THE BABY BELLS

Despite ho-hum growth in telecom services overall, **Verizon Communications** managed to blitz rivals. The nation's largest phone company said on July 27 that second quarter earnings hit $1.8 billion, up more than fivefold from $338 million a year ago. Revenues climbed 6% to $17.84 billion, outpacing **SBC Communications'** 2.2% increase, to $12.8 billion, and **BellSouth's** 1.6% rise to $6.7 billion. The wireless business led Verizon's charge, adding 1.5 million users in the quarter and boosting revenue 25%, to $6.85 billion.

CARDINAL'S AILING HEALTH

Richard Miller resigned as chief financial officer of **Cardinal Health** in the wake of questions about how the health-care giant classified its revenues. Considered a star finance exec when he became CFO in 1998, Miller came under pressure last fall when the **SEC** began an informal inquiry into Cardinal's handling of $22 million from vitamin manufacturers that overcharged the company. Miller's exit was coupled with the news that Cardinal will delay the release of its fiscal 2005 results. Cardinal revealed on June 30 that it received a subpoena from the SEC. It also cut its annual profit forecast.

ET CETERA...

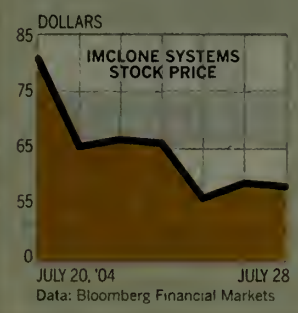
>> **Microsoft** co-founder Paul Allen acquired **Plains Resources** for $460 million.

>> Four former execs of **U.S. Foodservice** face securities-fraud charges.

>> **Energizer** shares tumbled 12% on earnings that were below forecasts.

CLOSING BELL

Shares of ImClone Systems have fallen 28%, to $58.52, since July 20 despite strong sales for Erbitux, its new colorectal cancer treatment. Analysts are afraid that royalty payouts may be higher than expected. Erbitux' $16,000-per-month price tag is also drawing fire.



TOKYO Custo
love Yahoo! B
high-speed
service

JAPAN

HARD TRUTHS FOR SOFTBANK

The broadband bet looks solid, but investors want to see profits

MASAYOSHI SON HAS often been criticized for being long on vision but short on delivery. In the mid-1990s, his Softbank Corp. focused on computer-magazine publishing, trade shows, and software distribution—with mixed results. Then, as the Internet started to take off, he spent more than $3 billion buying stakes in some 800 Net-related companies. "Masa" soon was playing the Nippon dot-com guru to the hilt—posing in samurai costume, shuttling between Silicon Valley and his Tokyo headquarters, giving inspirational talks at mass lovefests with Japan's first generation of Netrepreneurs. Like cherry blossoms in spring, though, it was over all too soon. His portfolio included winners, such as portal Yahoo!, but also plenty of flameouts, such as online retailer Webvan Group. When the Net bubble burst, Softbank's share price and earnings collapsed along with the rest of the sector.

End of story? Nope, just the prelude to Softbank 3.0. Son—now sporting an adult-looking suit and tie—is feeling feisty again. Softbank's stock, which had been flat-lining for years, is five tir higher than at its nadir in Novem 2002, and up 48% since January. Yah Japan—Softbank owns a big chunk of company—is roaring ahead, reporting 83% surge in quarterly profits from on retail services and auctions. Softban sitting on $5 billion in cash and unre ized gains of $17 billion on its portfolio stocks such as Yahoo, Yahoo Japan, a telecom-gear maker UTStarcom. A nance unit, built around online bro E*Trade Financial Corp., is making so money, too.

Finally, Son has, in his brash way, fied Japan's established telecoms to cre perhaps the slickest consumer-broa band service in the world. Yahoo! Son's high-speed Internet unit, off users service at some 10 megabits per s ond—and he expects to double that coming years, which would allow hig quality video streaming over the Net. T Japanese love Yahoo! BB: Some 4.3 m lion have signed up at $20 to $30 p month. With the addition of the broa band customers of Japan Telecom Co the country's No. 3 fixed-line provid which Son just bought for $3.1 billior Softbank should have the biggest broa band network in Japan by yearend, ec ing ahead of giant Nippon Telegraph Telephone Corp. "Sooner or later, eve thing is going to migrate to broadban says Son, Softbank's CEO.

vestors, though, want to know when bank will migrate to sustainable prof- There's no doubt that Son is back in game. But some of the doubts the ket has about the Japanese visionary in. The company has lost nearly $2 n over the last two years—pretty stiff by Son's grand standards. Some of is from write-offs on failed Net in- ments, but the lion's share is from the of creating a broadband empire. Soft- k has been burning through $100 ion a month building Yahoo BB's net- k and trying to woo subscribers to it. stock's rebound could be in jeopardy e company posts another major loss year, and the shares have already giv- ack some of their gains since Son laid billions for Japan Telecom. "It's going e a difficult situation for Softbank if fits don't happen" soon, says Naoki iwara, a fund manager at Shinkin As- Management Co.

EAR STRATEGY

N'S RESPONSE: "Our stock is really lervalued." From his vantage point, tbank—despite its still-capacious awl of 177 subsidiaries and nine busi- s segments, ranging from e-com- rce to consulting—has a ar strategic thrust these 's based on broadband. Ya- o BB, Japan Telecom, and Trade Japan form the core of t strategy.

What about that little profit blem? Son insists that if hoo BB were content simply serve the subscribers it now s, the broadband unit would ve $900 million in positive sh flow. But he insists the mpany can eventually be ich more profitable by ex- nding its subscriber base, so 's continuing to spend and pects to have 6 million cus- mers by fall, 2005. Once he ts subscribers in the door th his superfast service, he ys, he'll be able to tease ore money out of them by of- ring add-ons such as Inter- t phones, wireless network- g equipment, live sports rogramming, and music wnloads.

Son's other big earnings ve- cle will be Japan Telecom. hen the deal to buy JT closes November, Softbank will et 600,000 new residential roadband accounts. Another big contribution will be the $780 million in cash flow JT generated last year, which should improve Softbank's profit picture, notes Mizuho Securities Co. analyst Atsuo Takahashi.

It is JT's 170,000 corporate clients, though, that really interest Son. His plan: Turn stodgy Japan Inc. on to all kinds of cool Net-based services. Son wants to merge JT's 12,000 kilometers of fiber-optic cable with Softbank's more modest fiber network to offer corporate clients high-speed data communications. Then he plans to use that network to provide Japan Inc. with Internet-based phone service that will help companies slash their calling fees and maintenance costs. Megabanks UFJ Holdings and Mizuho Financial Group have already adopted Internet telephony, and in June, Tokyo Gas, Japan's biggest natural-gas utility, replaced its 20,000 phone lines with a system that routes calls over the Net. Problem is, all three companies looked to Softbank's rivals for those phones. Son wants a piece of that action—and there's likely to be plenty of it. By 2007, Japan is expected to have 28 million Net phones, up from 5.3 million today, according to Yano Research Institute Ltd., a Tokyo think tank.

By 2007, Japan may have 28 million Net phones—and Son wants a piece of that

The final leg of Son's plan counts on the continued success of Softbank's e-finance unit. Fortunes at the group, which includes a 35% stake in E*Trade Japan, two other regional brokerages, and a tie-up with fund-researcher Morningstar, have been lifted by the turnaround in Tokyo's markets and a surprising surge in online stock trading by individual investors. Today the unit has some $17 billion in assets under management, and it turned a $54 million profit in the fiscal year ended in March after losing the same amount the year before. To keep that business growing, Softbank on July 5 announced plans to buy midsize broker Ace Securities Co. for roughly $73 million.

Son's real task, though, is getting Softbank itself into the black. Because of its high losses and $1.3 billion in short-term debt, Softbank can't get an investment-grade credit rating. Some real earnings might change that—and Son vows to create them. He says the broadband unit will be profitable on an operating basis in the second half of this year, and that next year Softbank will benefit from some $460 million in cost savings from the merger with JT. That, he says, could swing Softbank into a profit in the fiscal year ending in March, 2006.

Confident as he is, Son can't help but be a little defensive. Hasn't he flipped and flopped over the years? No, he insists: "My strategy has been focused and steady." Focused, he says, on what comes next in the digital realm. And plenty of observers still admire his guts and vision. "Son has always thought big and taken big bets on the next big thing," says Neil Katkov, an analyst at telecom researcher Celent Communications. At some point, though, those bets have to pay off. For Son and his latest strategic plan, it's show time. ■

–By Brian Bremner in Tokyo

Softbank 3.0

Netrepreneur Masayoshi Son is revamping his business plan once again. Here are three areas that will need his attention:

BROADBAND

PROBLEM Though it has 4.3 million subscribers, Softbank's Yahoo! BB is losing $100 million a month and won't turn a profit until next year at the earliest.

SOLUTION A new focus on higher-margin corporate customers via Softbank's $3.1 billion purchase of fixed-line carrier Japan Telecom.

E-FINANCE

PROBLEM Despite tie-ups with online brokerage E*Trade and fund-researcher Morningstar, this division doesn't have enough reach.

SOLUTION The recovery of Tokyo's stock market has lifted its fortunes, and Son is adding muscle by buying smaller Japanese brokerages.

DEBT RATING

PROBLEM After losing nearly $2 billion in the last two years, Softbank can't manage an investment-grade debt rating.

SOLUTION Softbank could raise cash by selling some of its $17 billion in of Yahoo! and other Net companies. But generating profits is the real answer.

Data: Softbank Corp., *BusinessWeek*

its share in China has been cut nearly in h

GERMANY

VOLKSWAGEN SLIPS INTO REVERSE

In three years, the carmaker has gone from showcase turnaround to laggard

IT HAS BEEN A ROUGH RIDE FOR Bernd Pischetsrieder since the former BMW boss took over as chief executive at Volkswagen in April, 2002. VW's share price has fallen nearly 50% since then, as profits plummeted at the $150 billion company. On July 23, Pischetsrieder delivered more bad news—a 36% profit drop in the first half. Just to take even more air out of VW's tires, the boss issued a grim profit warning for the whole year.

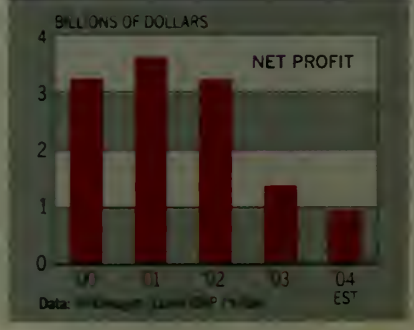
What's wrong? Volkswagen's vaunted brand premium—the implicit guarantee of quality and innovation that long allowed it to charge as much as 8% more than the competition for mass-market cars—is eroding fast. In the U.S., VW has slapped a $3,000 rebate on its aging Passat and joined the 0% financing game. The absence of a strong lineup of minivans and SUVs also hurts. Losses in the U.S. are likely to reach $1.4 billion this year due to falling sales and the impact of the weak dollar on reported results.

Another nasty surprise came in China, which has accounted for up to 24% of VW's operating profit. In late May, General Motors Corp., keen to dethrone VW as No. 1, cut prices by 11%: VW matched the move. GM's sales doubled in the first half of 2004, while VW's fell 4.2%. VW commanded half the mainland market in 1999. Now it controls just over a quarter. Pischetsrieder expects China sales to grow only 5% to 7% in 2004. "Our prime objective is profitability, not maintaining market share," he said on July 23.

What's the way out? Pischetsrieder has launched a plan called ForMotion to trim $2.6 billion in costs in two years, on top of an existing effort to squeeze costs by $1.1 billion a year. The plan seeks to cut $970 million in purchasing costs, $600 million through staff cuts, and $360 million in restructured sales activities.

A souped-up Golf is due later this year, and Passat and Jetta remakes debu 2005. In China, Pischetsrieder aim double VW's production capacity, to million cars, by 2008. VW is also in ducing fresher models—the Toua sport utility, the Phaeton luxury sec the Audi A6, and a car expressly desig for the China market. Pischetsrieder has a winner in Audi. Strong sales Audi's luxury A8, the new midsize and the hot A3 compact drove a 10% crease in operating profit, to $666 r lion, in the first half of 2004.

VW's SLIDE



LABOR PAINS

SO WHY AREN'T investors impress "VW is a huge ship. You can't turn it miles and miles," says George C. Peters president of AutoPacific Inc. in Tus Calif. Pischetsrieder's cuts will help, "VW has never faced up to its fundame cost problem. It has never faced up to unions," says John Wormald, a partne London-based consultant Autopolis. La costs for VW's factories are at 17.4% of r enues, vs. a European average of 15%, cording to Dresdner Kleinwort Wasserst

Pischetsrieder, a consensus manage also making little headway agains change-resistant bureaucracy. "Of top 100 managers, are not used to mak their own decisions thinking on th own," says an au industry expert w is close to the compa Looks like it's ti for a radical sh of gears. ■

–By Gail Edmond in Frankf with Dexter Robe in Beij

CAROL MATLACK

European Workers' Losing Battle

eir wage concessions may not be enough to keep jobs from moving abroad

FOR ANTONIO RIBEIRO de Sousa, who builds Mercedes-Benz diesel engines at a factory in Stuttgart, the writing is on the wall. On July 23, Daimler-hrysler's unions agreed to scrap an ex-ected 2.8% pay raise and extend some nployees' workweeks from 35 to 39 ours, with no extra pay. In exchange, orkers won promises that 6,000 jobs vered by the agreement will remain in Germany for at least ght years. But, says Ribeiro de Sousa, a 32-year veteran on the embly line, "Next time, they'll say they need a 40- or 42-hour rkweek, or they'll send production to South Africa."

De Sousa aptly describes the dilemma facing both workers d bosses in this summer of labor tension on the Continent. The ll-paid hands of Western Europe's biggest manufacturers have le choice but to make concessions on hours and pay: The aw of low-cost manufacturing elsewhere is just too strong. en after wringing concessions from their employees, compa-es will eventually ask for ore—or move production road to stay ahead in a fe-ciously competitive world.

Daimler is not the only mpany tightening the rews on employees. In ne, workers at two emens factories in Ger-any agreed to increase eir workweek from 35 to hours, after the company reatened to move jobs to ungary. Auto maker Seat, ter transferring some pro-uction from Spain to Slova-a, negotiated more flexible ork schedules with Span-h workers. Even France is aving second thoughts bout the maximum 35-our workweek enacted in 998. On July 20 employees t a Robert Bosch auto-parts actory near Lyon voted to start working an average 36 hours weekly, after the company said it might move operations to the Czech Republic.

That's quite an about-face. Over the past three decades, Western European workers, backed by tough-as-nails unions, have negotiated some of the world's cushiest work schedules. Just since 1990, the average number of hours worked annually has fallen 10% in France and 6% in Germany. Many Europeans work fewer than 40 hours a week and get at least five and sometimes as many as nine weeks paid vacation.

In all likelihood, though, the recent labor deals will only slow the outgoing tide of jobs. The wage differentials are just too huge. "When we find a certain product can be made with a 50% decrease in salary costs [in another country], we cannot avoid that if we want to stay competitive," says Bernhard Schreier, CEO of Heidelberger Druckmaschinen, a German printing-gear company that is considering setting up production in China.

Western European companies can find big labor savings even closer to home. In the Czech Republic and Poland workers earn less than a third the average wage in Germany and France, while spending some 500 more hours on the job each year. "Long term, there are going to be fewer factories in Europe," says Gérard Hauser, CEO of Nexans, a Paris manufacturer of electrical and telecom cable that has been scaling back production in France and Germany while ramping up in Asia and Latin America. Yes, German and French workers are more productive. But workers in emerging markets, with the help of state-of-the-art plants, are becoming more productive too.

A casualty of this process could be the strength of Western Europe's unions. At Bosch in France, union bosses opposed management's plan to lengthen the workweek. But fearful workers overruled the leadership, voting 98% for the plan. The trend could bring flexibility to notoriously rigid labor markets. But in many cases the lure of cheap labor abroad will still prove too potent for companies to ignore. ■

—With Katharine Schmidt in Stuttgart and Jack Ewing in Frankfurt

SEEING RED A DaimlerChrysler worker protesting cost-cutting plans

The East-West Divide

How workers in Western Europe compare with their counterparts in the Eastern bloc

COUNTRY	AVG. HRS. WORKED*	HOURLY LABOR COSTS (dollars**)
Germany	1,446	32.4
France	1,453	30.2
Britain	1,673	30.4
Poland	1,956	6.4
Czech Republic	1,972	6.5

* Data are for 2003 ** Data are for 2002 Figures include wages plus social contributions **Source:** OECD, Eurostat

Just before lunch, I phoned my largest and toughest client to recommend a major shift in his stock portfolio. He grilled me on the earnings reports and projections, but I was ready. I answered every question using the sophisticated analysis and clear, concise language of Standard & Poor's EQUITY RESEARCH.

Not only did he agree to the shift, he let me know that he had a few clients he'd like to introduce me to. It was the best cheeseburger of my life.

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ITED BY ROSE BRADY

aiwan: Uncle Sam Vants You to Buy Arms

JSED TO BE AN ANNUAL RITUAL: Taiwan's military attachés trekked Washington each spring with a huge weapons wish list. Bei-g, which considers Taiwan part of China, predictably erupted fury. The Pentagon would then scale back the size of the arms al. But times have changed. Today, U.S. military officials regu-y fly to Taipei to hawk sophisticated pons—as much as Taiwan can buy. "At point there are no real restrictions on at Taiwan can and cannot have," says n J. Tkacik Jr., a China expert at the itage Foundation.

Vhy the sales push? Pentagon officials deeply worried that China's economic wth spurt has fueled an arms buildup t has tipped the military balance across Taiwan Strait. For years Taiwan's air ver surpassed China's. Now the ntagon worries that China is catching thanks to its purchase of fighters, marines, and missiles, stly from Russia. Some Chinese missiles are ned at Taiwan. The ntagon's fears are cerbated by exercises h as Beijing's mock asion of Taiwan staged July.

TAIWAN'S NAVY Washington is eager to counter Beijing's buildup

ing China

ASHINGTON WANTS Tai-i to regain its edge. The ntagon figures China uld be less likely to attack better-armed Taiwan, and ipei would have less need U.S. aid in the event of mbat. Now Taiwan's legis-ure is considering a bill thorizing the purchase of $1.8 billion in eapons annually over 10 years—almost uble the size of recent purchases. The al includes close to 400 Advanced Patri-anti-ballistic missiles, 12 anti-submarine craft, and 8 diesel submarines.

The prospect of advanced arms deals is ing China's leaders, who fear that Tai-n's recently reelected President, Chen ui-bian, may push for independence in s second term. "The Chinese are kind of freaking out," concedes a senior Administration official. When National Security Adviser Condoleezza Rice visited Beijing recently, former Chinese President Jiang Zemin, who heads the Central Military Commission, warned her that China would not "sit idly by" if the U.S. sold key weaponry to Taipei. "China and the U.S. have the potential to reach conflict over the Taiwan issue," says Wang Yong, a Beijing University international relations expert.

The tension will rise this fall when Taiwan's legislature votes on the arms-purchase legislation. The lawmakers, though, are in a quandary. Most are aware Taiwan needs new arms, but because of the high price tag, legislators are fighting over what to buy—particularly since Taiwan's budget deficit is close to 5% of its gross domestic product. "There is no consensus over what is perceived as the immediate threat. Is it missiles, invasion, or air supremacy?" asks Andrew Yang, secretary general of Taipei's Chinese Council of Advanced Policy Studies. The arms deal is also becoming an issue in legislative elections set for December because voters prefer funds to be channeled to social welfare or education. "There is a mounting campaign by the public to stop the purchase," says Philip Yang, a security expert at National Taiwan University.

Whatever the lawmakers decide, the Pentagon is sure to keep pressuring Taiwan to upgrade its military. The complex diplomatic dance involving Washington, Taipei, and Beijing gets trickier by the day.

–By Stan Crock in Washington, with Matt Kovac in Taipei and Dexter Roberts in Beijing

GLOBAL WRAPUP

A NEW PUSH FOR REFORM IN GERMANY

GERMANY'S OPPOSITION Christian Democrats stirred controversy even within their own ranks by proposing a rollback in regulations that make it hard to fire unwanted workers. Economists say Germany must deregulate its labor market to spur hiring, but easing job protections is a sensitive topic among Germans feeling insecure after years of rising unemployment. The Christian Democrats' call for reduction of no-fire protections for new hires and older workers shows that Chairman **Angela Merkel** is increasingly willing to risk her political capital in the name of economic reform. The party has the support of 43% of the voters, vs. 26% for Chancellor **Gerhard Schröder's** Social Democrats, according to a recent poll by Berlin's Forsa.

BEIJING IS WORRIED ABOUT HONG KONG POLL

NERVOUS ABOUT losing control of Hong Kong's **Legislative Council** in elections scheduled for Sept. 12, Beijing representatives in Hong Kong are urging less popular pro-government candidates to quit in favor of more popular ones. Legislator **David Chu**, who is also a representative in China's Parliament, dropped out of the race, apparently under Beijing's pressure, shortly after campaigning kicked off on July 22. A pro-Beijing party left the campaign two days later. Beijing worries that public support for the cause of universal suffrage will help the pro-democracy camp win most of the Council's 30 directly elected seats. A recent survey predicted that democrats could secure 16 seats, while the pro-government camp could win 10, with 4 seats hotly contested.

STRESS ON SERVICE Concierge claims centers do the work of finding a body shop

Can Progressive Stay in Gear?

With rates falling, the car insurer is trying innovative ways to keep ahead of the pack

SAY YOU'RE IN AN AUTO accident. You're not hurt, but your car is so banged up that it's not worth fixing. Now imagine that instead of sending you a check so you can go car shopping, your insurance company combs the classified ads and the Internet for you to find a new set of wheels. That shopping service, which Progressive Corp. is testing on dozens of Ohio customers for a year, is just one of the company's latest spins on the mundane business of insuring drivers and their cars. Progressive isn't ready yet to say if the service, which is free to customers, will become a regular offering. But Thomas A. King, Progressive's treasurer, insists: "It's amazing. Customers love it."

That's a good thing, because if Progressive wants to stay ahead of the pack, it's going to have to shift into overdrive. Based in Mayfield Village, Ohio, the nation's No. 3 auto insurer, behind State Farm Insurance Cos. and Allstate Corp., has posted soaring growth in recent years, thanks in part to the sort of hefty premium hikes that customers don't love (chart). Progressive's average annual 183% profit growth and 152% total return since 2001 made it No.1 on our most recent BusinessWeek 50 ranking of top-performing large companies.

THE BUSINESSWEEK FIFTY 50 The Best Performers

LOYAL CUSTOMERS

BUT LATELY, GROWTH has been slowing. For the first half of 2004, net premiums in Progressive's core auto insurance business were up 13%, vs. 29% a year earlier. And with a weaker stock market, total returns on Progressive's investment portfolio were only 1.2% in the first half, down f 5.2% the prev year. In total, enues rose 18% $6.6 billion. cause claims falling, net income in the first half of year grew 46%, to $846.3 millior healthy gain for sure, but far below previous year's 72% rise.

Still, Progressive's focus on finding novative ways to make life a little be for its customers engenders a lot of lo ty, giving it a cushion in tough tin "They get and keep customers by putt emphasis on service," says Ira Zucl man, an analyst at Nutmeg Securit That's one reason premium income is pected to grow 12% this year, while the dustry average will be 4% to 5%, e mates Sandler O'Neill & Partners ana Nicholas Pirsos. Besides testing the sh ping service in Ohio, Progressive is panding its "concierge" claims cent where a customer can bring a dama car and get a rental while Progres handles the headache of finding a b shop. The centers even lend custome text-message pager to transmit upda Progressive says the 20 centers it oper in 18 cities also boost efficiency by spe ing inspections and repairs. But it knowledges that the centers work onl densely populated areas with a crit mass of customers.

In yet another bid to develop servi Progressive is evaluating a system t takes personalizing premiums to max. In a Minnesota test earlier this y the company put a computer chip in c tomers' cars to record wl they were driving, how they went, and how f they drove. Then, w hookups provided by company, people went line and uploaded the inf mation to Progressive. (D vers were free to view data first and decline send it if they chose.) After crunching numbers, the insurer wants to see if it tailor rates individually, charging less, for someone who rarely drives in r hour. Progressive hasn't decided whet to proceed with the system.

Progressive is going to need those novative services to help it hold on to c tomers and keep its premiums high as creases in insurance rates industryw slow or as rates even fall. Already, such vals as USAA and Farmers Insura Group have reduced rates. State Farm the price of insurance in 30 states by

To accomplish more,
sometimes you need to see less.

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to 13.6%, thanks to falling claims. That put pressure on Progressive. In May, for instance, it reduced the price of some Florida policies by 4.4%.

Adding some urgency to the rate slowdown is uncertainty about the volume of claims. The number of claims at Progressive and throughout the industry has been falling—down 3.5% in the last 12 months alone. Nobody knows why, or if the falloff is a fluke or an ongoing trend. Progressive's King worries "when, if ever, accident frequency will increase to historical levels," since higher payouts eat into profits. Some analysts chalk up the decline to "smarter" cars that help avoid accidents or to high gas prices, which deter driving. A theory Progressive favors is that the number of insured cars has outpaced the number of drivers; think two-income couples with three cars. Nevertheless, Progressive can't rely on falling claims forever.

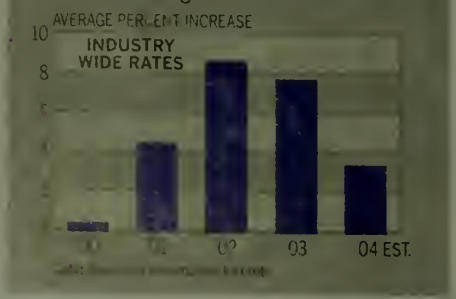
The number of claims has been on a decline

Nor can it count on its rivals becoming less aggressive. Allstate, for instance, is boosting its marketing spending by $175 million this year and is a sponsor at the Olympic Games. So Progressive, which has long stressed the ease of buying its policies by phone or on the Net, is devising an ad campaign, likely to launch in 2005, that plays up the 30,000 independent agents that sell its insurance. Progressive, after all, has zoomed along in the last few years. The last thing it wants now is to stall and sputter while its rivals bear down. ■

–By Louise Lee in San Mateo, Calif.

CAUTION: OBSTACLES AHEAD

Progressive has benefited from big jumps in auto insurance rates. But now those rates are starting to fall.



POWER PLAYER Dalton will head Indiana University governance center

A Different Kind of Governance Guru

Dan Dalton, a debunker of conventional wisdom, may get to shape board reform

DAN R. DALTON LOVES to stir up controversy. The former business school dean, who has been studying corporate governance for 25 years, has staked out positions that contradict virtually everything today's corporate reformers hold dear. Board independence, separation of CEO and chairman roles, stock ownership by directors and executives—none of these good governance tenets can be definitively linked to a company's bottom line, insists Dalton. "I wouldn't deny that I like being a lone wolf," he sa

Dalton made a name for himself a gadfly in governance circles while d of Indiana University's Kelley Schoo Business, a post he has held for the p seven years. But this fall, the 57-year- PhD in strategic management will more of an equal among other gov nance gurus when he becomes direc of Indiana's new Institute for Corpor Governance. The institute is the lates a growing crop of university-based g ernance centers, director-training p grams, and other efforts to help rest investor confidence and prepare cor

ns for the rigors of life e era of Sarbanes-Oxley. n many ways, Dalton is a ral choice to lead Indi- s center. A prolific re- cher who has been a essor and administrator ndiana's Kelley School e 1979, he has authored o-authored several hun- l journal articles on ns of topics from CEO succession to pricing. And although controversial, corporate governance studies have nered respect among fellow academ- even those whose research concludes opposite—that there is a correlation ween good governance practices and roved financial results.

But his appointment is riling the oppo- ts in the governance world who find ton's work misguided. Bob Monks, nder of proxy adviser Institutional reholder Services, calls Dalton's brand research "academic self-indulgence." ers fault Dalton for relying on meta- lysis, which involves drawing conclu- ns from dozens, even hundreds, of pre- usly published studies by other hors. The criticism: It doesn't include tradictory findings from unpublished dies. Long used in fields such as psy- logy but rarely in business, meta- dies often produce counterintuitive re- ts. For a debunker of conventional dom such as Dalton, that's a powerful w. But reformers like Monks dismiss findings as beside the point—focusing financial performance when the aim of d governance is to provide a check on nagerial power.

Against the Tide

Dan Dalton suggests that many favored governance reforms don't lead to better financial performance:

- Separation of chief executive and board chair doesn't lead to better financials
- Equity holdings by execs and directors don't align interests enough to contribute to increased profits
- There's no connection between independent directors and better bottom-line results
- Small boards don't perform better than big, unwieldy ones

Data: Dan Dalton

> A critic calls his research "academic self-indulgence"

Dalton admits his research is limited by its reliance on financial performance data but argues that the measures he uses—revenues, earnings, and market returns, among others—are the same gauges adopted by investors to judge companies. And surely one goal of the reform movement, he says, is to improve financial performance through governance changes. "The clear tone [of Sarbanes-Oxley] is that by following these prescriptions, you will have a company that will perform better for shareholders," says Dalton.

A CARDINAL SIN

DALTON'S EXPERIENCE isn't just academic. He was a director of First Financial Bancorp, and in his first two years the Ohio bank underperformed its peers. But the board paid then-CEO Stanley N. Pontius handsomely, giving him a big increase in cash compensation one year and a salary hike and bigger option grant the next. During that period, the compensation committee included Barry S. Porter, the CFO at Ohio Casualty Corp., where Pontius sat on the compensation committee that determined Porter's pay, a board "interlock" that's considered a cardinal sin of corporate governance. Dalton defends the payout, saying the First Financial board's chair—and head of the compensation committee—was an outside director and that the company was in the midst of a costly but crucial reorganization in those years.

Still, Dalton vows that the new corporate governance center won't veer too far from mainstream reforms. "Just because behaving reasonably doesn't have direct rewards doesn't mean we should not behave reasonably," he says. For one thing, Dalton believes in independence, but not in the traditional sense; boards should have their own budgets to hire outside counsel and consultants who'll be beholden to the board, not management. And the center will teach in its executive-education courses and custom programs that the practices and procedures boards follow matter more than board composition and should be determined by directors themselves.

A good start from a naysayer. The challenge for Dalton will be to move beyond his focus on what doesn't matter in the governance arena and become an advocate for what does. ■

–By Jennifer Merritt and Louis Lavelle in New York

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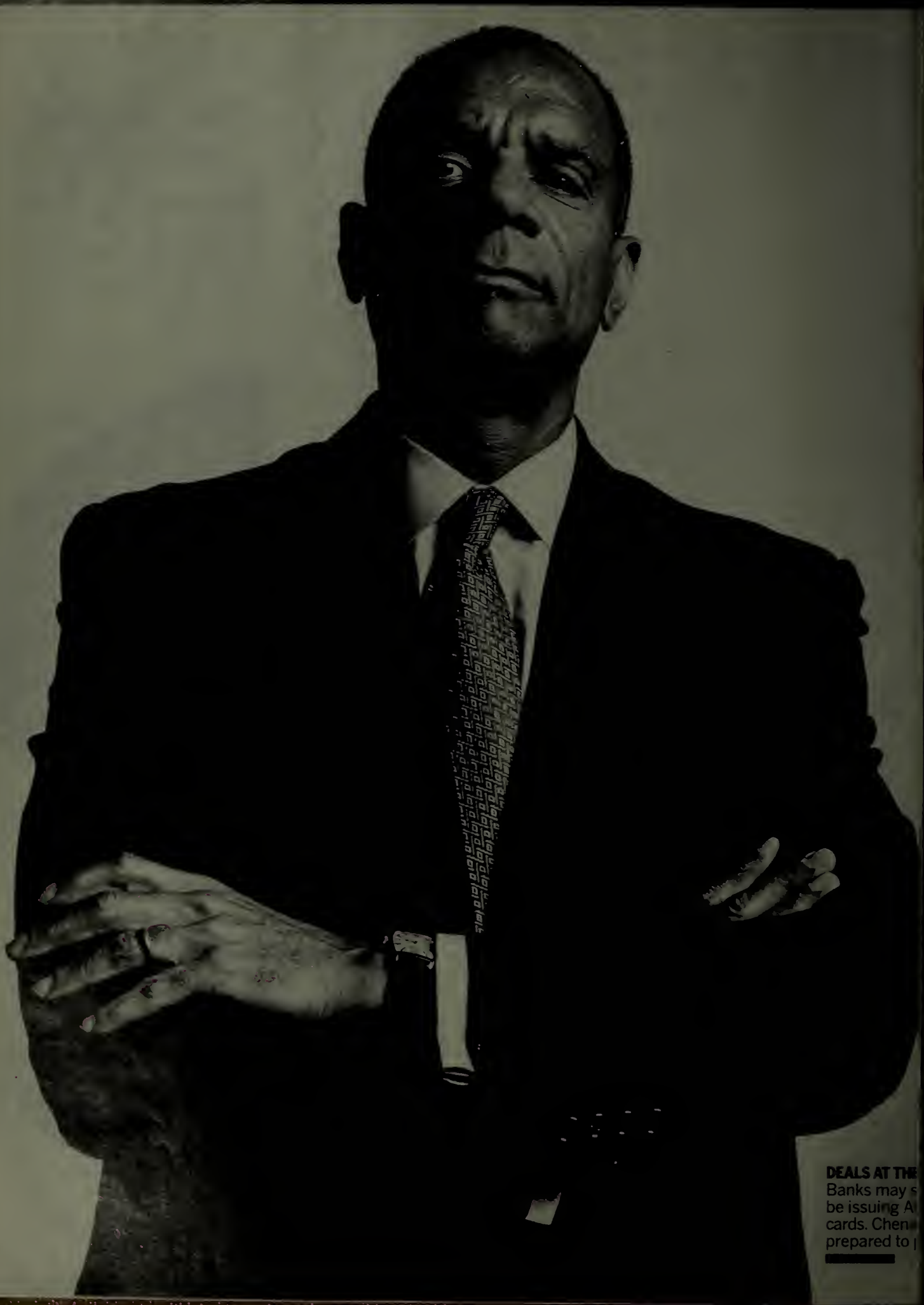


DEALS AT THE
Banks may s
be issuing A
cards. Chen
prepared to

CHARGE!

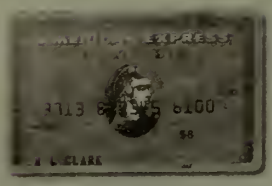
American Express CEO Ken Chenault is about to launch a huge credit-card war. Backed by an antitrust ruling, he's gunning for Visa and MasterCard. Let the fight begin. BY MARA DER HOVANESIAN

S IS THE MOMENT KENNETH I. CHENAULT, chief executive of erican Express Co., has waited for his entire career. As a fresh uit in charge of strategic planning more than two decades , he sought to move AmEx beyond its lucrative niche as an cale charge card—an idea too radical for the company's old rd. Later, as head of consumer cards, he began a dogged paign against industry giants Visa USA Inc. and MasterCard rnational Inc. and the lock they have on issuing cards ugh banks. "I've had a willingness to take on conventional ws, to shake things up," says the 53-year-old Chenault.

Villingness is one thing, opportunity another. And now nault has both. This fall, the U.S. Supreme Court is expect- o uphold a ruling by the U.S. District Court for the Southern trict of New York that Visa and MasterCard—which togeth- ontrol 79% of the U.S. card market—stifle competition and ovation by forbidding the banks that own them from issuing l cards. For the first time in its 154-year history, AmEx will e carte blanche to issue plastic through U.S. banks and flood market with millions of its green, gold, and platinum cards. e ruling, the culmination of an antitrust case launched by the pt. of Justice six years ago, "will create competition in our in- stry for the first time," says David W. Nelms, chairman and O of Morgan Stanley's Discover Financial Services Inc. unit.

The Supreme Court's decision—and Chenault's plans to exploit it aggressively—would change the $2.1 trillion card business for good. Already, the industry is in the midst of the biggest fight in its history for share of a saturated market. All the major brands and banks are in a frenzy to woo fickle high spenders. Their weapon of choice: souped-up rewards programs, a marketing tool AmEx pioneered. AmEx now gives big cash rebates and mileage points redeemable for space travel. U.S. Bancorp offers private yoga lessons with actress Gwyneth Paltrow on its new Stratus Rewards Visa cards. And in the hunt for more outlets, once-exclusive cards such as Citigroup's Diner's Club will soon be accepted in Wendy's as well as the Waldorf-Astoria. Says John C. Grund, partner with First Annapolis Consulting Inc., a Maryland-based industry specialist: "It's now a matter of how to steal share from one another, innovate, and tap new markets."

The free-for-all is ushering in the long-predicted cashless society. Uncle Sam takes plastic; welfare benefits and salaries are paid by loading a card with cash. Yet American consumers still use cash or checks to pay for about 59% of the $8.2 trillion a year they spend on everything from housing to hamburgers. If the card industry can capture even a modest part of those $4.8 trillion cash outlays, it will experience fast growth. *The Nilson Report,* an industry newsletter, forecasts combined debit- and credit-card



AmEx charges higher fees, but many merchants appreciate its cardholders, who far outspend Visa and MasterCard users

spending will grow 13% a year through 2007. "You're talking about the most profitable retail banking product in the world. The competition among the titans is going to be fierce," says *Nilson* publisher David Robertson. "They are already clobbering each other."

The slugfest seems certain to whack the card companies' margins, which are under legal attack by merchants and regulators. AmEx has the most to lose. It charges merchants about 2.6% of customers' bills, more than the roughly 2% levied by Visa and MasterCard. Indeed, AmEx's average fee fell by 2.3% last year, according to company filings. Traditionally, card companies have been loath to negotiate on fees. But some merchants are being so ardently courted that they're able to bargain. In April, Costco Wholesale Corp., the nation's No. 1 warehouse retailer, signed a 10-year exclusive contract with AmEx because it got better (but undisclosed) terms than rivals would offer. "Visa and MasterCard's fees are outrageous," says Costco CEO James D. Sinegal. "Neither gave us any wiggle room."

Hey, Big Spender

WITH HIS MARGINS UNDER PRESSURE, Chenault must drive up how much consumers spend using his cards. He's doing just that; in the second quarter this year such spending leapt 19%, topping $100 billion for the first time. His strategy is simple: First, he wants to get more cards in people's hands by persuading banks to switch customers from Visa and MasterCard to AmEx. Then he aims to coax cardholders to spend more—and, while they're at it, buy other AmEx products.

AmEx isn't looking to snag just any customer from Visa and MasterCard. It wants those from the affluent investor class, who earn between $100,000 and $1 million a year. They charge up a bundle, keeping the card's profile high, and pay off their balances in full. With thousands of new big spenders in the fold, Chenault's battalion of 12,000 financial advisers would move in to sell them advice and financial plans, which start at $500 a pop. Then they'll sell insurance and investment products, including AmEx's own. "We have to be the No. 1 provider to high-spending customers for both cards and financial advice," says Chenault. "We will have an advantage because we have a very clear focus on these customers."

At the same time, AmEx will step up its drive to wean large companies and small businesses from checks to corporate plastic. Analysts figure a $400 billion-a-year U.S. market for procurement as well as payroll is up for grabs. And, although AmEx is five times bigger than its nearest competitor in providing commercial cards to small-business owners, Chenault is chasing after a bigger share of their $4 trillion worth of spending. Just $90 billion of those outlays are made with credit cards.

Even before AmEx issues its first card through a U.S. bank, competitors are fighting back. They are promoting heavily gold and platinum cards aimed at AmEx's high-end customers. In mid-July, Visa launched a media blitz for its redesigned Signature Card, through which customers spent $80 billion last year. MasterCard is revamping its World MasterCard. Brokerages and banks are wading in, too. "A lot of cards don't completely meet the needs or desires of the upper class," says Christopher L. Pieroth, senior vice-president of product and marketing for U.S. Bancorp of Minneapolis, the eighth-largest U.S. bank, which launched its Stratus Rewards Card in April. Cardholders can accumulate points toward private tours of the Louvre and Egyptian Pyramids, as well as private jet travel. "The players are recognizing this is a very lucrative market; you are going to see a big push."

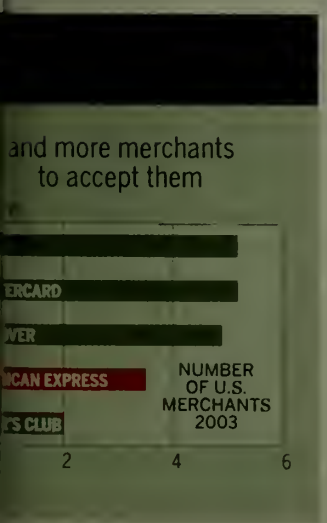
Chenault is betting the high status of AmEx' cards can help him grab a good chunk of future market growth. The key is to make his cards stand out among the 848 million circulating in the U.S. today. Last year, s 8,000 card issuers mailed five billion solicitations—40 household. The response rate has plunged. Instead of add cards to their wallet, people now replace the ones they have, John Gould, a director at Tower Group, a Needham (Mass nancial consultancy. And that, he says, should should open door for AmEx: "They are creative. They have something o

WHY AMEX NEEDS TO EXPAND ITS FRANCHISE

CHART BY ERIC HOFFMANN/BW

LAST FRONTIER All the card companies are pushing hard into the small-ticket end of the market

st to the issuers that Visa and MasterCard do not—prestige." AmEx has more to offer than just prestige. Because it charges chants about half a percentage point more than Visa and sterCard, it can afford to give banks a bigger slice of its fees. mix appealed to MBNA, the first bank to strike a deal to issue Ex-branded cards as early as the end of this year. That was te a coup for Chenault. MBNA issues more MasterCards and Visas—some 56 million altogether—than any other bank. "You generally don't like helping your competitors, but sometimes it makes sense," says MBNA Chief Executive Bruce Hammonds. "We are both able to make more money and expand our business." McLean (Va.)-based Capital One Financial Corp., another big customer of the giants, could be the next convert, say analysts. (Capital One declined to comment.) Meantime, Chenault is courting dozens of banks he thinks would sign on if the courts outlaw Visa's and MasterCard's restrictive contracts.



Chenault's gamble could pay off big on AmEx' bottom line. For one thing, the banks issuing AmEx cards will bear the cost if customers don't pay their bills, which AmEx shoulders on its own cards. And, with more cards in circulation, Chenault should be able to extract significant economies of scale from AmEx' network linking merchants, banks, and customers. "More cards will be issued, more merchants will choose to take the card, and the economics of the entire firm start to lift," says Howard K. Mason, a senior bank analyst with Sanford C. Bernstein & Co. For each 10% rise in card billings, he figures, AmEx will incur just 1.5% more in network costs. So AmEx' current 20% return on equity should get a big boost. Adds Richard Freeman, a management professor at New York University's Stern School of Business: "If they get access to the bank business, I think there is a huge potential upside."

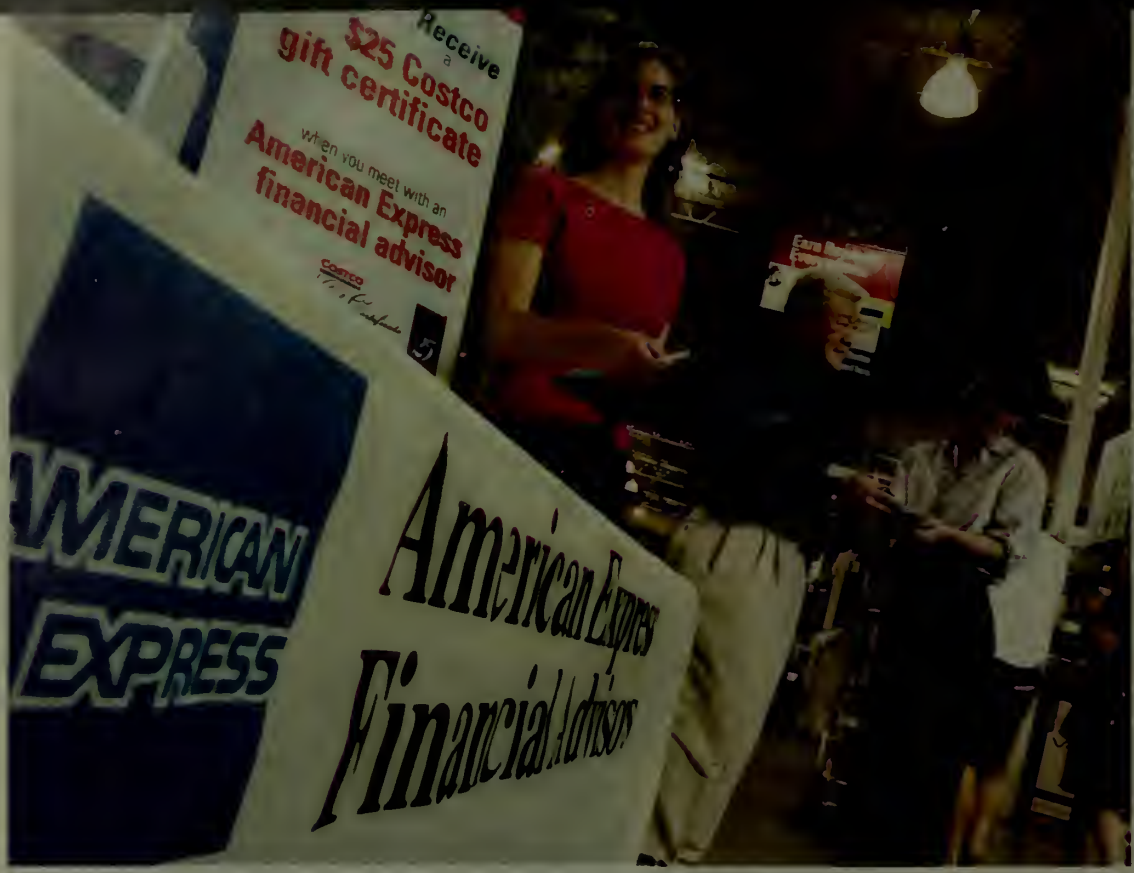
Fancy Footwork

FIRST, THOUGH, CHENAULT has to pull off some fancy footwork. His trickiest maneuver will be to recruit millions more cardholders without diluting AmEx' gold-standard brand. According to the *BusinessWeek*/Interbrand 2004 ranking, it was the 14th most valuable in the world, worth nearly $18 billion. What's more, AmEx won't have debit cards, which are growing 17% a year—twice as fast as credit cards, until Chenault sets up a system to link them with bank accounts. And the money-management business is still recovering from years of missteps. For the last three years, less than one-fifth of AmEx' 72 retail equity mutual funds ranked in the top quartile of their peer group, according to fund-tracker Lipper Inc.

In fact, Chenault has to juggle several problems simultaneously if he is to achieve his goal of dominating the high end of both the card and financial-advice businesses. He has to gain market share without allowing AmEx' margins to shrink too much. He has to coax enough extra merchants to accept his card and pay his higher fees. And he has to persuade banks to let him offer AmEx' financial services alongside their own. "Who owns the consumer?" asks William H. McCracken, chief executive of the consumer market researcher Synergistics Research Corp. in Atlanta. "Is it the issuing bank, or American Express, or both? If it's both, that raises some thorny questions."

For now, banks seem attracted by AmEx' willingness to pay them more. But Chenault's main rivals are trying to close the gap. In April, they raised their merchant fees on credit cards by about 5%, so they can pay banks more, according to *Nilson*. Critics say the ploy is bound to backfire. "If the strategy is to help banks reach more into merchant's pocket, that's a dangerous prospect," says Kenneth A. Posner, credit-card analyst for Morgan Stanley, who figures half of the $24 billion a year they already earn from such fees could be at risk.

Merchants are already upset. Last year, they wrestled a $3 billion settlement (to be paid over 10 years) from Visa and MasterCard in an antitrust class action, led by Wal-Mart Stores Inc. The suit alleged that the card groups strong-armed merchants into paying high fees for debit-card transactions, which the groups denied. Some big merchants who opted out of the class action, including Home Depot, are still seeking damages in other suits. Discover, for one, sees an opportunity. "We could be the solution



AMEX EXCLUSIVE Costco signed a 10-year deal after AmEx beat its rivals on fees

for angry merchants," says Discover's Nelms. Merchants pay up to 15% less on average to Discover than Visa and MasterCard, according to The Nilson Report. "We obviously are taking to heart the lessons," adds Robert W. Selander, president and CEO of MasterCard. "If you settle for a billion dollars, obviously, you do more than just write some checks." Bottom line: MasterCard is ready to haggle with big merchants.

The Merchant Gap

NOW, AMEX IS FACING A CHALLENGE over its own fees. Last August, attorney Blaine H. Bortnick of New York's Liddle & Robinson and Gary B. Friedman of Friedman & Shube filed an antitrust suit on behalf of several small merchants alleging that AmEx charges excessive fees. "The Wal-Mart case was part of the inspiration," says Bortnick, who is trying to gain class action status for the suit. AmEx says it will fight such cases vigorously.

Such suits would appear to be a major headache for Chenault. AmEx gets about 65% of its card revenues from merchant fees, while Visa and MasterCard generate about 20% of revenues from their share of the merchant fees. That's because rivals rely on interest on outstanding balances, while AmEx depends on high levels of spending. Chenault expects to sacrifice some of his margins to grasp the opportunity presented by unfettered competition. By cherry-picking banks and merchants, he believes he can increase not only the number of transactions on his card but also the amount spent on each. Says Chenault: "I'm not complacent or unaware of the pressures. The burden on us is that we have to deliver value for the premium price."

What the merchants value most is the number of high-spending clients that Chenault can deliver. AmEx customers are attractive because they use their cards more often than those of rivals and spend an average of more than $8,000 a year—about twice as much as Visa MasterCard users. Chenault is playing c up with Visa and Ma Card. They each have million merchants on rosters, vs. 3.5 millio AmEx. "We're everyw AmEx wants to be," Tim Attinger, a senior executive.

By some meas that's streets ahead AmEx. Visa's 430 mi cards account for $1.1 lion in spending in the vs. AmEx' 35 million c that account for $26 lion in charges. V everyday spending cat ry is growing about billion a year or 5.5%, marily thanks to cards. "AmEx is a n player today and is g to be even more so bec of the explosive gro that's coming in pre and debit," says Elizabeth Buse, executive vice-presiden product development at Visa.

Chenault aims to close the gaps by launching new p ucts and rewards programs galore to entice customer spend more. AmEx' Blue card—aimed at capturing every spending on items from groceries to dry cleaning postage stamps—now offers up to 5% cash rebates and ble bonus points. New prepaid cards loaded with cash, w AmEx may customize for big-ticket events such as wedd and bar mitzvahs, are designed to tap a market worth s $105 billion. And it's testing ExpressPay, a payment de linked to its cards and activated by radio, at more than locations, including chains Eckerd Drugs, Blimpie Sub Salads, and Carl's Jr. And AmEx is pushing hard to get ch cards accepted by landlords and cash-or-carry whole suppliers. Last year, for example, it teamed up with York's Related Cos. to allow tenants to pay their rent plastic at 16 luxury buildings.

Because Chenault's whole strategy hinges on his abilit keep his cardholders spending big, he will be picky ab which banks he signs up. Their customers will have to sp enough to maintain AmEx' averages. He also insists that banks use some of the extra money they earn from him to velop their own customized rewards programs. If banks d deliver, "we absolutely pull the plug," says Chenault. That' idle threat: Chenault ended a card deal with Canadian Imp al Bank of Commerce (CIBC) by mutual agreement in June ter just 18 months. "The cards were not meeting our finan objectives," says CIBC spokeswoman Susan McDougall.

Critics contend that such tough conditions could d some banks from issuing AmEx cards. Chenault counters he's offering far more than just cards. For a fee, commu banks, credit unions, and midsize banks will be able to AmEx' expertise in corporate T&E and procurement cards small business, two areas in which it is a market leader. S have sold AmEx annuities for years. Chenault says he can

Chenault believes he can strike lucrative deals with the banks. One ace in the hole is AmEx' lead in corporate T&E and small business cards

s do a better job selling investments and advice to the af-
t. Banks account for about 17% of $180 billion in annual
ual-fund sales and 1% of $480 billion life insurance sales,
rding to Celent Communications LLC. Says U.S. Ban-
's Pieroth: "Banks are probably not the most creative
n it comes to targeting niche markets." Indeed, banks are
behind brokers who have captured nearly two-thirds of
ales of investments to high net worth customers.

Pursuit of Investors

X NEEDS NEW OUTLETS to sell its financial planning
ices—and banks offer a tempting prospect. The more
s Chenault sells, the more likely he'll sell other products:
year, financial plans sold by AmEx advisers led to three-
rters of the $1.4 billion of mostly retail sales by the compa-
Minneapolis-based American Express Financial Advisors
(AEFA) unit. If banks bristle at the idea of AmEx' advisers
ng to their customers, Chenault won't insist—though he
ks they would be making a mistake. "Customer needs and
petitor pressures [are opening] up the system," he says.
He is also pushing large companies that offer AmEx funds in
r 401(k) retirement plans to host investment seminars.
h programs accounted for about 18% of AmEx' new clients
year. And he has placed advisers in more than 300 Costcos
onwide. Existing cardmembers have yet to be tapped for
r full potential, says James M. Cracchiolo, AEFA's chief ex-
tive. He figures they have about $80 billion in cash and in-
ments at banks and brokerages that he would like to con-
date at AmEx.
Financial plans may be an easier sell than AmEx' invest-
nt products. Since he became CEO, however, Chenault has shuffled AEFA's executive management, hired new money managers, and added a new lineup of products for retail and institutional investors. New lines such as the AXP Partners funds, managed by top-notch firms such as Gabelli Asset Management Inc. and Wellington Management Co., have performed better than AmEx' in-house funds, averaging a one-year 14% return, vs 8%. Better yet, they've attracted $4.8 billion from retail investors since January, 2001. The result: AEFA revenues rose 18% in the second quarter, and assets grew 55% to $380 billion over the past year.

Skeptics doubt whether Chenault can snare big outfits such as Citigroup, which is busy building its own credit-card brand and financial-services business. Citi's chief operating officer and president, Robert B. Willumstad, told analysts in February that a partnership with AmEx was unlikely, though executives from the two companies have met. Besides, Citi put its high-end, but languishing, Diner's Club (the first charge card on the market, since 1950) in direct competition with AmEx by partnering with MasterCard in April. However, Bernstein's Mason figures they may relent, if only to give their customers a choice. "Attrition is a nasty thing," he says. "Citi and others must factor in the cost of not doing business with AmEx." Adds MasterCard's Selander: "It's certainly not going to be an exodus; my guess is it will be more of an experiment."

Whatever obstacles Chenault faces in the U.S., he knows that his strategy has been road-tested abroad. And it worked. Wherever AmEx has been free to sign up banks, competition for cards and financial services has thrived. Since its launch in 1999, AmEx' global network services, one of its fastest growing divisions, has signed up 84 banks in 94 countries. Last year, its billings topped $12 billion; spending jumped 30% in the second quarter.

In his three years as head of AmEx, Chenault has faced several severe tests. Four months after he became CEO in January, 2001, the company was rocked by revelations of a $1 billion loss on a junk-bond bet gone bad. Then, September 11 not only dislodged AmEx from its Lower Manhattan headquarters but also stopped the company's core corporate travel and entertainment business in its tracks. Profits halved and AmEx' future looked so bleak that rumors flew around Wall Street that it might soon be snapped by the likes of Citigroup. "Anything that could have been thrown at us was," says Chenault.

He soon regained the initiative. He swallowed

EN CHENAULT'S BLUEPRINT OR REINVENTING AMEX

1 GET MORE CARDS INTO CONSUMERS' HANDS

GN UP U.S. banks to market cards and convert their Visa d MasterCard customers to new Platinum, Gold, and reen cardholders

KPERIMENT with new oducts, such as ExpressPay, prepaid, radio-activated card at requires no signature

USH the reloadable avelFunds and gift cards to place traditional travelers' ecks and gift certificates

2 SPUR CARDHOLDERS TO SPEND MORE

ENABLE them to use their cards in new places such as fast-food restaurants, dry-cleaners, gas stations

ENCOURAGE payment of cable, phone, and other monthly bills with plastic

OFFER luxury rewards such as concierge services and private jet travel to big spenders

PAY instant cash rebates of up to 5% on everyday spending

3 PUSH FINANCIAL SERVICE SALES

GIVE customers more investment choices such as access to hedge funds and 12 new mutual funds managed by outside money managers

TEAM up with Costco to offer auto and homeowners insurance, credit, and financial planning

TAP big corporate clients to sponsor investment seminars at which employees meet with AmEx advisers

Data: *BusinessWeek*, American Express Co.

the $1 billion loss on junk bonds and cut risky corporate lending in half. As business disappeared in the wake of September 11, he slashed 14,500 jobs, 16% of the workforce, and outsourced 2,000 tech jobs to IBM. By the end of this year, he will have shaved a cumulative $4 billion off costs. "Investors were doubtful that the company could recover," says analyst David A. Hendler of CreditSights Ltd. "Chenault has done an awesome job."

It was a job of building as well as cutting. While other CEOs hunkered down during the recession, Chenault bought two companies—AmEx' first sizable acquisitions in more than a decade. Since 2002, he has pumped $7.8 billion into marketing, promotion, and rewards programs—almost 12.2% of revenues. Bolder still, he turned AmEx' business model on its head. Before September 11, two-thirds of its card billings came from corporate T&E and a third from regular consumer spending. By last year, the ratios were reversed. "We are engaged in a important transformation for this company," says Chen "American Express is a new story."

A story with a big payday, at that. On July 26, AmEx re ed record profits of $876 million and record revenues of billion for the second quarter. Says former IBM Chairman L V. Gerstner Jr., who ran AmEx for 11 years and recru Chenault from consultants Bain & Co. in 1981: "Once he fig out what he needs to do, he has the drive to take the risk an make it happen. He is a superb problem-solver."

The solution to his latest challenges lies in the hand consumers. His competitors won't surrender ground with struggle, but Chenault believes their customers will switch t card when they get the chance. As he tells bankers he's trying to sign up: "Change is in the cards." It surely will be i Supreme Court changes the rules of the game. ■

THIS BLACK CARD GIVES YOU CARTE BLANCHE

A real T-shirt-and-jeans kind of guy, Peter H. Shankman certainly doesn't look like a high roller, but American Express Co. knows better. After he was snubbed by salesmen at a Giorgio Armani boutique on Fifth Avenue in New York recently, the 31-year-old publicist—who was made available to *BusinessWeek* by AmEx—saw "an unbelievable attitude reversal" at the cash register when he whipped out his black AmEx Centurion Card. In June, a RadioShack cashier refused the card, thinking it was a fake. " 'Trust me,' I said. 'Run the card,' " recalls the chief executive of Geek Factory Inc., a public-relations and marketing firm. "I could buy a Learjet with this thing."

An exaggeration, perhaps. But AmEx' little black card is decidedly the "It" card for big spenders. Launched in late 1999, Centurion is given out by invitation only to customers who spend at least $150,000 a year on other AmEx cards and meet other requirements. The chosen cardholders pay an annual fee of $2,500, raised from $1,000 two years ago.

Although AmEx has spent zilch on promotion, some would-be customers go to absurd lengths to get what they see as a must-have status symbol. Hopefuls have written poems to plead their case. Others say they'll pay the fee but swear not to use the card—they want it just for show. "Every week I get phone calls or letters, often from prominent people, asking me for the card," says AmEx' head of consumer cards, Alfred F. Kelly Jr.

Who, he won't say. In fact, AmEx deliberately builds an air of mystery around the sleek card, keeping hush-hush such details as the number of cards in circulation. Analysts say AmEx earns back many times what it spends on perks for black-card customers in both marketing buzz and fees.

STATUS SYMBOL
AmEx offers the Centurion to customers like Shankman who bill $150,000 a year

The card is now being flattered by imitators. In April, Merrill Lynch & Co. and MBNA Corp. launched a black-colored Visa card with a credit limit of up to $250,000. The card offers bonus points that can be used to pay for brokerage charges—or a night at the Ritz "Our goal wasn't to come out with a me-too card," says Peter Barsoom, director of card payments for Merrill Lynch. "Our clients need ed a better card in their wallet." J.P. Morgan Chase & Co. also is sizing up its own version Says Jamie Dimon, the bank's chief operati officer and president: "We may want to try to outdo that at some point."

Basic services on the Centurion card include a personal travel counselor and concierge, available 24/7. Beyond that, almost anything goes. Feel like shopping at Bergdorf Goodman or Saks Fifth Avenue at midnight? No problem. Traveling abroad in first class? Take a pal—the extra ticket is free.

The royal treatment often requires elaborate planning. One AmEx concierge arranged a bachelor party for 25, which involved a four-day trip that included 11 penthouse suites, travel by private jet, and a meet-and-greet with an owner of the Sacramento Kings basketball team. The tab was more than $300,000.

How did Shankman, who says his firm has no business dealings with AmEx, earn his card? All the travel and entertainment charges he racks up hosting his clients prompted AmEx to send it to him. It arrived in December, along with a 43-page manual. Recently, Shankman sought reservations for Spice Market, an often-overbooked restaurant in Manhattan, to impress a friend. He called his concierge. "Half an hour later it was done," says Shankman. Membership does have its privileges.

–By Mara Der Hovanesian in New Yor

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STYMIED Donaldson is seeking a "meaningful consensus"

Man In The Hot Seat

SEC Chairman Donaldson is under pressure from all sides to craft a compromise on letting shareholders nominate company directors

CORPORATE CEOs are seething at the idea of any rule. They fear it would allow dissidents to pursue narrow agendas.

REPUBLICAN LEADERS, girding for a tight election, don't want Donaldson to antagonize business before November.

DONALDSON wants to avoid another 3-2 split decision on a third hot-button issue that would align him with Democrats.

SHAREHOLDER ACTIVISTS balk at limiting investors to a purely advisory role in board nominations.

Data: *BusinessWeek*

The Agony Of Compromise

The SEC's Donaldson is finding a deal on proxy reform elusive in an election year

IT'S BECOMING A LONG, HOT Washington summer for Securities & Exchange Commission Chairman William H. Donaldson. He's laboring to produce one of the most important expansions of shareholder democracy since the 1940s, but no one is happy. Corporate chieftains are up in arms. The White House wants the issue to go away until after the Nov. 2 election; with a close race, it's no time to tick off key supporters. Shareholder activists are demanding more than they're likely to get. And the five-member commission is split at least three ways. Vows Donaldson, "We're going to work on it, but we won't ram anything through until there's meaningful consensus."

Any major change in corporate governance is bound to raise hackles. The fight is over whether to allow shareholders to nominate directors to corporate boards and have them listed on the annual proxy ballot. But figuring out how to do so with at least the grudging acceptance of key players has been tying the SEC in knots for months. Now, *BusinessWeek* has learned, agency officials are quietly exploring a compromise that would encourage boards to agree with large investors on a new director if 35% of shareholders—or 50%, excluding shares held in broker accounts—withhold their votes for the company's nominee. "The key is to make sure a majority of shareholders gets a fair shake," says Commissioner Harvey J. Goldschmid, who has championed giving shareholders a bigger voice in nominating directors.

Proponents of the new rule would like to see it adopted in time for next spring's proxy season. Potential targets abound. This year, shareholders have withheld at least 35% of their votes from more than 25 directors up for election, according to a preliminary count at 115 companies Automatic Data Processing Inc. For ample, 45% of Walt Disney Co. sh holders withheld their votes from C Executive Michael D. Eisner and m than 50% of Federated Departm Stores shareholders gave four direc thumbs-downs.

But a deal may prove elusive. The c mission's two Democrats, Goldsch and Roel C. Campos, back the orig proposal for shareholder access to proxy ballot that the SEC put out for c ment last October. It would let big vestors put their own candidate on ballot if 35% of shareholders withl their votes for a company-nominated rector the year before. Donaldson v comed it warmly at the time, but insic say he and another Republican comm sioner, Cynthia A. Glassman, now lean ward a more limited rule. Paul S. Atk the SEC's third Republican, says he concerns about the measure.

'POWERFUL SIGNAL'

NOW, THE TIGHT PRESIDENTIAL r could make it tough for any comprom until after the election. Business frets t the measure would let labor and ot groups use board elections to push th own agendas. So the White House wa to avoid giving business any excuse to on its hands during the campaign. S staffers say politics plays no role in chairman's policy decisions.

Donaldson also doesn't relish anot divided vote by the commission o high-profile issue. While the commissi

ıave been unanimous in most of votes, they have split 3-2 over two s key priorities, regulating hedge s and requiring mutual-fund chair- to be independent of the fund- agement company. In both cases, SEC chief sided with the two De- rats, a fact that grates on some Re- icans. Says one SEC insider: "He'd to avoid another 3-2 vote, particu- on this issue."

fter the election, shareholder ocracy won't be such a political der keg. If President Bush is re- ed, Goldschmid and Campos might their objections to a more modest ıtion of the earlier proposal that aldson and Glassman are said to fa- This version, which has tepid sup- at best from business, would give eholders the right to nominate a lidate after a majority no-vote for company's nominee, but the board ld preempt that by choosing a new ctor on its own.

Senator John F. Kerry wins the ite House, Donaldson might have to e closer to the two Democrats' posi- to get a rule adopted before step- g down. Goldschmid and Campos ıld have no incentive to budge: Ker- as publicly backed the drive to give reholders a better shot at nominat- directors.

Truth be told, anything could happen r the election. That's why some in- tor advocates think that getting the re limited approach approved quick- better than risking the possibility of SEC shelving the idea altogether af- the election if a compromise can't be nd. "If there's a large withheld vote l the company arranges for that di- tor to step down, it sends a powerful nal to other companies to pay atten- ı to whom they put on their boards," s Sarah Teslik, executive director of Council of Institutional Investors.

But labor and other institutional in- tors are wary of making too many ıcessions. "If there's going to be an ess rule, it should grant access," says er C. Clapman, senior vice-president TIAA-CREF.

Despite such competing pressures, naldson's resolve to forge a deal ows no sign of waning. After all, he t the ball rolling a year ago when he ected SEC staffers to find a way to en up director elections at companies ıere boards have long ignored in- stors. But it may be hard for the chair- an to keep his cool this summer. ■

–By Amy Borrus in Washington

Dude, Where's My Carb?

Pizza and bread companies discover that there's life after Atkins

THE ATKINS DIET HIT few companies harder than Panera Bread Co. With Americans swearing off bread while going whole hog for Atkins and other low-carb regimens, same-store sales at the sandwich chain were flat or down in six of the 12 months through mid-June. And Panera's stock price tumbled by nearly a third, bottoming at $32.50 on July 14.

But folks may be ready to load up on carbs once again. Recent surveys suggest that the low-carb craze could be cooling as dieters grow tired of skipping doughnuts, pasta, pizza, and other high-carb favorites. Panera, in Richmond Heights, Mo., expects 2% to 3% year-on-year monthly sales gains through the second half of the year. "Atkins is material and real," says Chairman and Chief Executive Ronald M. Shaich, "but it is not the end-all and be-all."

Investors seem to be noticing. The shares of Panera Bread, Krispy Kreme Doughnuts, pizza chain Papa John's International, and pasta restaurant operator Buca have all turned up smartly since mid-July, bucking the overall market's decline.

Although Dr. Robert C. Atkins started pitching his weight-loss program 30 years ago, it didn't become a phenomenon until last year. All at once, restaurants that make dough by selling it found themselves shunned. Minneapolis' Buca, which runs 105 Buca di Beppo eateries, saw same-store sales drop 7% last year, leading to a $12.3 million loss. Buca's share price, which traded at more than $7 early last fall, reached a 52-week low of $4.42 on July 15 before starting to rebound.

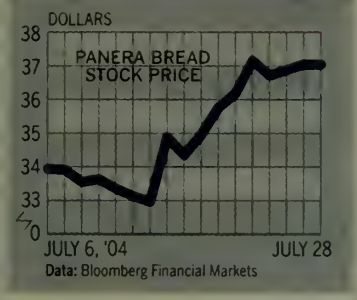
Restaurants have helped themselves by adjusting their menus. Buca began dishing out smaller portions instead of just its trademark heaped plates of pasta. Panera is offering six low-carb breads.

Now, ever eager for new ideas to sell stocks to investors, Wall Street has glommed on to hints that enthusiasm for low-carb diets may be waning a bit. Food-industry analysts at Morgan Stanley polled 2,500 adults in June and found that 10% were on low-carb diets, vs. 12% in January. The poll has a plus or minus 1.2 percentage-point margin of error. Morgan Stanley analysts say they expect the decline to continue for the rest of the year.

The Street may be onto something. NPD Group, an independent market researcher, has also tracked the falloff. It believes low-carb diets peaked in January. "Americans will always try new things," says NPD Vice-President Harry Balzer. "But these new things become part of our lives only if they make things easier or cheaper. Atkins doesn't do either." So, please, pass the bread. ■

–By Michael Arndt in Chicago

BRINGING IN THE DOUGH



Data: Bloomberg Financial Markets

A Renaissance for Russian Science

Student enrollments are up, and multinationals are chasing grads

IT'S AN EMERGING-MARKET economy that still suffers from widespread poverty—but somehow manages to produce more than 200,000 science grads a year. Students so well-trained in computer science, physics, mathematics, and engineering, that growing numbers are being snapped up by some of the world's biggest tech companies.

India? Wrong. China? Nope. The correct answer is Russia. "We continue to see very good students come out of the universities," says Steve Chase, president of Intel Russia. When it comes to writing complex computer programs, "the Russians are absolutely tops," he adds.

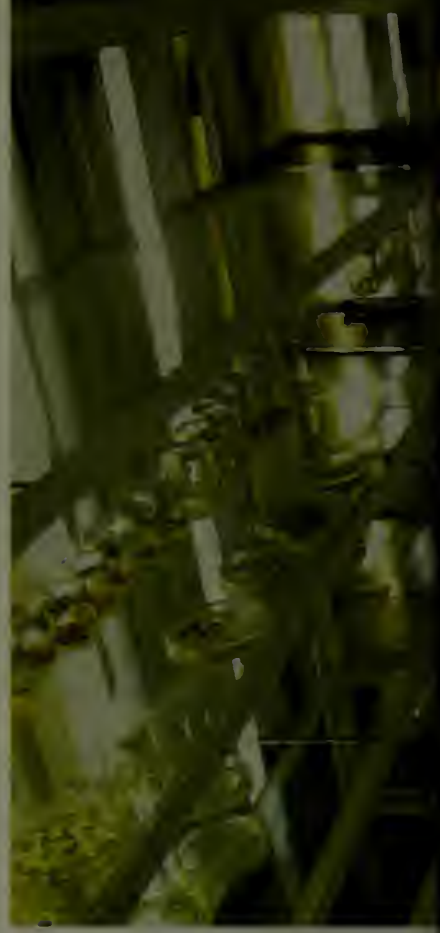
It's one of Russia's surprising survival stories—the resurgence of the country's once-superb scientific education system. State funding for scientific research and education plummeted with the collapse of the Soviet Union, and many of Russia's best and brightest left the country, lured by higher-paying jobs abroad. But Russia's universities and scientific institutes are slowly adapting to the harsh realities of a market economy, by tapping private funding and research contracts and forming partnerships with international heavyweights such as Intel, IBM, and Cisco Systems. Meanwhile, enrollment in science courses is rising once again.

That's the good news. The bad news is that the ranks of Russian academia are thinning, as most of the newly minted science grads are recruited by the private sector or foreign universities. Without an influx of qualified teachers, Russian science may be living on borrowed time. "Russian basic science is still at a very high level, but when the current generation of teachers retires, the experience may be lost," warns Irina G. Dezhina, senior researcher at the Institute for the Economy in Transition in Moscow.

WOWING THE WORLD

FOR NOW, AT LEAST, Russians young and old continue to wow the world with their scientific and mathematical talent. As has happened in three of the past five years, a Russian university won top honors at the 2004 ACM International Collegiate Programming Contest, an IBM-sponsored competition that pits university teams from around the world against each other in solving complex problems. Universities in the ex-Soviet Union took 10 of the top 30 slots this year. "The educational system has become shaky but still works well," says Natalia Kasperskaya, CEO of Kasperskaya Lab local software company.

Putin and Sadovnichiy are working to recruit more young professors



The system might have collapsed a gether without a recent increase in s support, made possible by Russia's e nomic revival since the end of the 19 coupled with a growing stream of priv funding. Government spending on ence is up by 90% since 1998, althoug remains a fraction of what it was un communism. Meanwhile, private fina now makes up around 45% of all resea funding. "The 1990s was a difficult ti for the whole system of education, since 2000 we have been able to w more or less normally," says Niko Kudryavtsev, rector of the Moscow In tute of Physics & Technology. Founded Joseph Stalin's personal orders in 19 Phystech remains one of Russia's lead scientific universities. These days the stitute no longer gets its electricity cut because of unpaid bills—and can even vest in much-needed student dormitor

Some of the partnerships between a demia and the private sector have alre began to bear fruit. Take Unichimtel company founded by a group of Mosc State University researchers with help of local investors. The enterprise vented Graflex, a material that can used to insulate everything from elec

LEAN TIMES Russian R&D spending is only half the French and German levels

les to space ships, and now employs ıe 700 university chemists and re-rch students. "It's a good example of cooperation of Moscow State Univer- with industry. That's exactly what our ·nce needs now," says Moscow Uni-sity Rector Viktor Sadovnichiy.

OUTING TALENT

SSIAN SCIENCE is also getting a help-hand from international heavy-ghts. Trailblazer Intel Corp. began rking with a half-dozen Russian uni-sities back in 1997. Intel Russia Presi-ıt Chase explains that the chipmaker ıally starts off with an equipment do-ion, and gradually becomes more in-ved, helping develop curricula, and ·n contracting out work to university earch staff. Right now, a team at Nizh- Novgorod State University is helping el develop security software for high-ed wireless communications.

But the biggest draw for Intel is the ance to scout for new talent. "We're rly doing this because we want a good eline [of students] in the future," ex-ins Chase. Intel already employs 500 ıssian engineers at research centers in oscow, St. Petersburg, and Nizhny Nov-rod, and plans to recruit 500 more this ar. Chase says Russian programmers are remarkable for their creative approach and for their grasp of complex mathematical algorithms. It helps, he says, that unlike their counterparts overseas, many of the best Russian programmers trained as physicists, chemists, or mathematicians.

Luckily for Intel and others, there's a growing pool of Russian science grads to fish in. According to research by Auriga Inc., a Russian information-technology company, this year's graduating class of computer scientists, engineers, mathematicians, and physicists will be 11% larger than last year's, totaling 225,831. Despite the recent vogue for management or marketing, Russian youth is rediscovering its traditional interest in old-fashioned science. Moscow University's Sadovnichiy says there are now six applicants for every place at the university, compared with just two or three in the mid-1990s, with the most intense demand for places on science and mathematics courses.

Trouble is, these newly minted grads are opting out of teaching, so Russia's professorial ranks are graying. "The main problem is low salaries," says Walter Pogosov, 28, a recent graduate of Phystech, who now works as a postdoctoral researcher at Okayama University in Japan. Pogosov earns $3,700 a month in Japan, while an assistant professor in Russia collects a mere $100 a month. He says around half of his classmates are working or studying abroad, while others have become millionaires in Russia by ditching science for banking or business.

According to a report that Moscow State University's Sadovnichiy prepared for the Russian government earlier this year, almost two-thirds of Russia's scientists are over 40. If current trends continue, 42% will be over 60 by 2010. In March, Sadovnichiy presented his findings to President Vladimir V. Putin himself. "It seemed that the President is very interested," he says. To draw more candidates into science careers, Sadovnichiy recommended a range of steps, from channeling funding to the most promising research areas, to allowing innovative scientists to get more of the commercial benefit from state-funded projects.

A further boost in state funding would help enormously. Despite the increases in recent years, Russia spends just 1.24% of gross domestic product on research and development, half the level of France or Germany, and a 60% decline from 1990 levels. The comparison is less flattering still when defense-related research—still a huge chunk of Russia's science budget—is excluded. Still, even expatriates like Pogosov aren't ready to write off their homeland. His ambition is to earn enough money in Japan so that one day he can return home to work as a scientist. With dedication like that—and more support from government and business—Russian science may yet have a future as well as a glorious past. ■

–By Jason Bush in Moscow

The Graying of Russia's Laboratories

Distribution of scientists by age, 2000

USA	RUSSIA
Below 39	Below 39
48%	27%
60+	60+
7%	21%

Source: Sadovnichiy report

HIGH STAKES Cyberthu stepped up their attac as Smarty Jones bid f the Triple Crown

Gambling Sites, This Is a Holdup

Organized criminal hackers threaten to paralyze their networks if they don't pay up

SOMETHING NASTY WAS up. It was an autumn afternoon in the offshore gambling haven of Costa Rica. The banks of computers at online bookmaker Betcris.com whirred away, processing thousands of bets on the Cowboys, Patriots, and Buckeyes. All at once a flood of blank incoming messages inundated the computers, slowing traffic to a crawl. Within hours, the manager of Betcris.com, Mickey Richardson, received a threatening e-mail. The English was broken, but the message was clear: What he had experienced was a mere taste of a massive denial-of-service attack. If he wanted his computers to stay up and running through the football season, he was to wire a total of $40,000 to 10 different accounts in Eastern Europe.

This was the beginning of a wave of computer extortion has raged through the billion online-gamb industry for the past r months. In that time h dreds of attacks have b launched against on casinos, say indu sources. Richardson, v refused to pay, strugg for three weeks to mo cyberdefenses as a dig shakedown gang subjec his network to escalat assaults. "They'd kn me down for a weeke let me up on Mon knock me down Wednesday," he s While Richardson held plenty of other online c nos in Costa Rica, the Caribbean, a Britain weighed the potential lost reve and frayed customer relations—and d out the protection money. "We had to it," says Kevin Martin, manager eHorse.com, a Costa Rican operation t wired $30,000 to extortionists last fall

With this step into extortion, denial service attacks are becoming a lucra racket. In the Web's early years, hack unleashed similar attacks against likes of Microsoft Corp. or the Record Industry Association of America simpl strut their power or voice political gri ances. Now they want cash. And onl casinos make an easy first target. Illega the U.S., many are based in countr such as Costa Rica and Antigua, wh police are ill-equipped to battle sophi cated international cybercrime. Cas operators, some of whom face ille gambling indictments in the U.S., gro that the FBI does little to battle atta against offshore gambling sites. The I declined to discuss the details of any vestigations, but a spokesperson s that, as a matter of policy, "we purs anything illegal on the Internet." Still,

Extortion at Online Casinos In Three Easy Steps

1 Crime rings distribute viruses to tens of thousands of unprotected computers, which turn them into armies of so-called zombies that the extortionists then control.

2 They orchestrate these zombies to send blizzards of messages to an online casino's Web site. These slow traffic to a crawl, giving casino operators a taste of the extortionists' power.

3 In ransom e-mails to casino operators they threaten to shut down the site wit massive attacks just before big events such as the Super Bowl or the Preakness. Co to stay up and running: $30,000 to $60,000.

ıgency keeps a far lower profile than ritish counterpart. Online gambling ,al in Britain, and the country's Na- l Hi-Tech Crime Unit leads the glob- nt for these cybercriminals.

ıe extortionists may be just begin- to flex their muscle. Industry experts that they could soon target govern- t operations, e-commerce companies, .s—practically any organization with nline presence. While the worm at- that crippled Google Inc. and other h sites for hours on July 26 does not ar to be linked to extortion, it onstrates that even the mightiest are vulnerable to floods of digital ic. "It's only a matter of time before ave an extortion threat," says Peter J. mbers, chief executive of Affinity In- et Inc., a Fort Lauderdale-based com- that manages Web sites for ,000 companies.

MBIE ARMIES

S RISING MENACE will likely push panies both large and small to forti- ıeir defenses against denial-of-serv- ıttacks. It also poses a growing chal- e for police around the globe. On 20, Russian authorities working ı British police notched table success. Follow- a trail of payments, arrested three Rus- ıs in St. Petersburg who e allegedly linked to on- -gambling extortion. l, experts say other syn- ıtes carry on. "We've ıtified at least five ups, including two from na and one from the ldle East," says James Herrera, president of tcullis Technologies Inc., a cyber- ense company based in Miami.

These groups assemble vast armies of nputers for their attacks. They enlist m by reaching into unsuspecting mes, universities, and corporate cubi- s worldwide. The first step is to locate orly defended computers, preferably h always-on broadband connections. e world is teeming with them. Next y circulate viruses that place tens of usands of target computers under ir control. These are known as zom- s. The extortionists then mobilize ir zombies to bombard the target ver with torrents of requests for in- mation. There are about a dozen riations of these denial-of-service at- ks. But all of them either overtax the ocessing power of the servers at the gambling sites or jam up pipelines. The result is digital gridlock, effectively shutting down communications between the site and its customers.

For a gambling site, a shutdown before the Super Bowl or the Kentucky Derby can spell disaster—lost revenue, angry customers, and a bad reputation. Each site has a high period of vulnerability, and gambling execs say the extortionists play these to a tee. They hammered American-oriented casinos during football season, hit horse bookmakers just as Smarty Jones bid for the Triple Crown at the Belmont Stakes, and stepped up attacks on European sites during June's soccer championships in Portugal.

Since last fall, hundreds of casinos have hurried to build defenses. Now an entire industry is responding to serve this growing market. Companies such as Cisco Systems, Juniper Networks, and Top Layer Networks, a Boston area company, sell hardware to block these attacks. But the boxes, which average about $50,000, don't do the trick alone. So new service companies, such as Portcullis and DigiDefense International, are gobbling up contracts to customize defenses. They divert attacks onto their own networks, where they filter out the malicious messages.

Experts fear extortionists could target government, banks—any site at all

Last fall's attack on Betcris.com provided a sobering look at the extortionists' power. For three frantic weeks, the attacks grew in force by a factor of 60. Richardson exchanged more than 100 e-mails with his assailants, who continued to raise their ransom demands. Finally, the hackers turned their attention elsewhere. Since then, says Richardson, his defenses have fended off further attacks.

The digital gangs' greatest vulnerability is when they collect the ransom. Last November, British police helped arrest 10 suspects in Latvia charged with collecting payments from British sites. "They were the mules who were just picking up the payments," says Colin Walker, general manager of Canbet, one of the British gambling sites that sent money to Latvia. Those low-level couriers, according to the police, provided information that led to the Russian arrests in July. For now it's in distant locales that these extortion battles are raging. But chances are this scourge won't stay offshore for long.

–By Stephen Baker in New York, with Brian Grow in Atlanta

BusinessWeek

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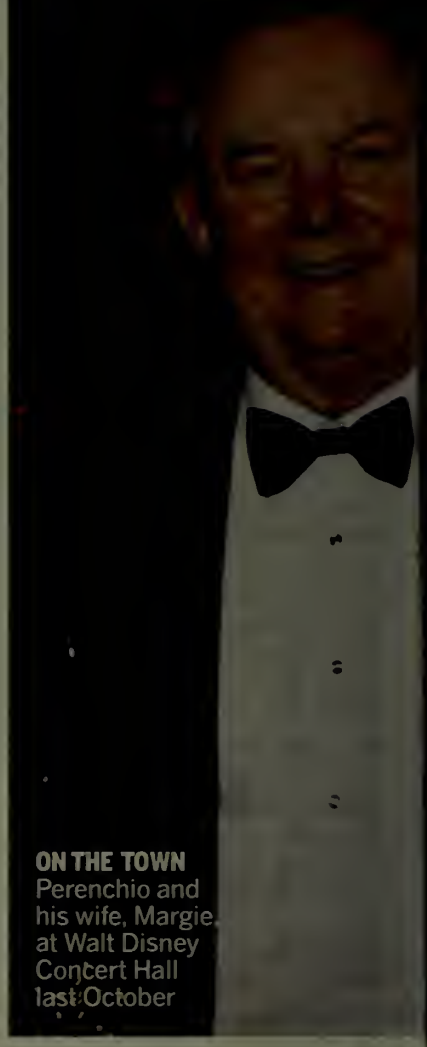
The Heavyweight On Latin Airwaves

Jerry Perenchio's sprawling Univision network gives him huge Hollywood clout



ON THE TOWN Perenchio and his wife, Margie, at Walt Disney Concert Hall last October

THE MOST POWERFUL mogul in Spanish TV distrusts the media, rarely gives interviews, and doesn't even speak Spanish. He's a jet-hopping, 73-year-old former boxing promoter who pals around with George Bush (41 and 43) and lives in the sprawling Bel Air (Calif.) mansion featured in the 1960s sitcom *The Beverly Hillbillies*. He loves throwing lavish parties—once he even flew in Henry Mancini and Andy Williams to perform at his son's 1981 wedding. Still, to most people in Hollywood, where as a talent agent he once championed the careers of Elizabeth Taylor and Marlon Brando, Jerry Perenchio is an enigma.

In an era of publicity-courting media moguls such as Rupert Murdoch and Sumner M. Redstone, the self-possessed Andrew Jerrold Perenchio quietly runs what may be one of the more valuable pieces of media real estate in the business. Univision Communications Inc., with two broadcast networks, a cable channel, a radio network, and three music labels, is the biggest player in the fast-growing Hispanic market, which today includes one in every seven Americans. Perenchio made an early bet on what seemed like a niche market by buying five TV stations and a struggling Hispanic network. Today that niche has exploded into a demographic phenomenon: Univision draws more young viewers in prime time than MTV and more men than ESPN, according to Nielsen. And in Hispanic-rich markets such as Los Angeles, Miami, and Phoenix, it often beats English-language rivals to snare the younger viewers advertisers crave.

AN IRON HAND

THE PAYOFF: UNIVISION nearly doubled its profits in 2003, to $155 million, on revenues of $1.3 billion. Adjusted for stock splits, shares have more than tripled, to about $28 a share, since the company first went public in 1996. And Perenchio is firmly in control. He takes no salary but owns an 11.5% stake.

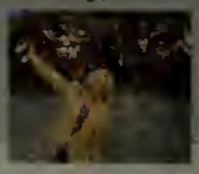
For all of Univision's success, though, few folks really know what's on Perenchio's mind. Perhaps more than any other media company, Univision reflects the secretive, often combative personali its boss. The onetime college boxer well into his 60s when he wrestled a b ness partner on a snowy sidewalk out a Manhattan restaurant over who g pick up the check. At Univision, Pe chio rules with a 20-point manifesto demands that employees think big, a mistakes, practice teamwork, and " people smarter and better than you." No. 1 rule: "Stay clear of the press. out of the spotlight. It fades your Only promote the brands."

Jerry's Growing Turf

CEO Perenchio doesn't speak Spanish, but through $1.

UNIVISION NETWORK

Reaches 98% of U.S. Hispanic households. Has a 62% share of Hispanics 18-49 watching prime-time. Big draws are Cristina and Sábado Gigante.



TELEFUTURA

Started in January, 2002, it reaches 79% of Hispanics. No. 3 to NBC's Telemundo, it recently moved ahead in ratings for daytime programming. Has 15% of Hispanics 18-49 in prime time. A top show: *Guerra de los Sexos*.

GALAVISION

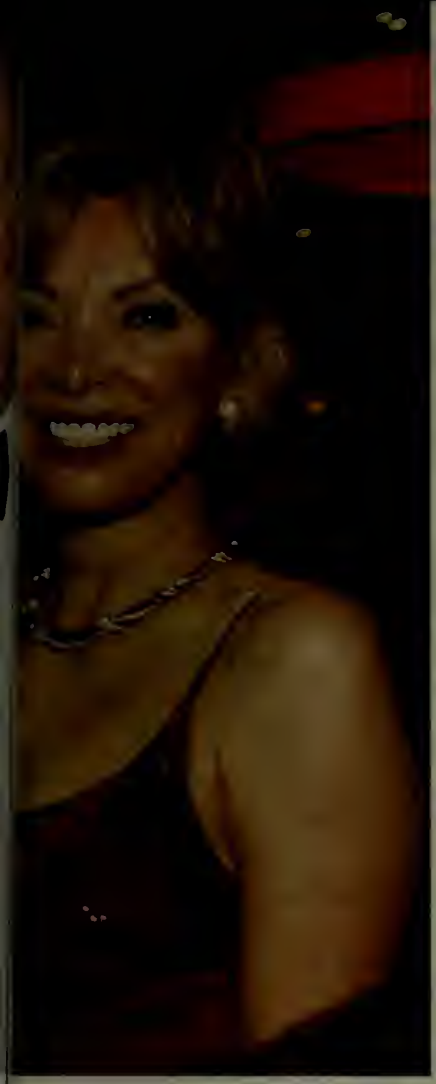
Spanish-language cable network reaches 108 U.S. TV markets. Mexican League soccer games draw a huge viewership.

TV STATIONS

Owns 56: Of the 18 Univision stations, 11 are in the top-15 markets. Of Telefutura's 18 st 11 are in the top-15 markets. Fresno (Calif.), Houston, Los and Miami affiliates are the to stations among 18-to-34-yea

2003 TV revenues: $1.1 billion

(TOP) ALEX BERLINER/BERLINER STUDIO/BEIMAGES; (BOTTOM, LEFT) JEFFERY ALLAN SALTER/CORBIS; (BOTTOM, RIGHT) ALEXANDER SIBAJA/GETTY IMAGES



erenchio is hardly a Howard Hughes-recluse, though. He and his third ·, Margie, are spotted at movie pre-res and courtside at Los Angeles Lak-ames. And he is not shy about throw-his support to politicians; he has ated millions to high-profile nocrats and Republicans in recent rs. "He's one of the most powerful s in this city, but he doesn't like being the limelight much," says former rner Bros. Chairman Robert Daly, o plays in a regular poker game with Perenchio. "He just likes people to leave him alone."

Not surprisingly, Perenchio politely turned down a *BusinessWeek* request to be interviewed, saying in a letter: "I would love you to do a fair and balanced story about our company." In building Univision over the past 12 years, however, Perenchio hasn't always been so genteel. Univision executives, say those who deal with them, push advertisers to pay hefty rates and have tried unsuccessfully to require them to buy ads on the two-year-old Telefutura network and Galavision cable channel along with Univision spots. "They went at it very aggressively and it ruffled a lot of feathers," says Jessica Pantanini, vice-president of media-buying firm Bromley Interlink, which spends $60 million a year on Univision. The company declined comment.

"THAT QUIET CHARM"

IN ADDITION TO advertisers, Univision battles rivals, unions, and even partner Grupo Televisa, the Mexican TV giant that provides one-third of Univision's programming and is a 9.4% owner. Perenchio's execs themselves aren't spared: When a top lieutenant gave an unauthorized interview to the press in 1995, Perenchio fined him $25,000. On June 9, Univision took on powerhouse Nielsen Media Research Inc., suing the rating agency, alleging its new service undercounts Hispanics in markets like L.A.

Univision draws more youth than MTV and more men than ESPN

It's not unusual to hear Perenchio compared to hard-boiled Hollywood bosses like Jack Warner. "Jerry is from the old school: If he doesn't get what he wants, he has a volatile temper," recalls movie producer Jake Eberts, who worked for Perenchio's Embassy Pictures studio in the mid-1980s. He says he was fired when he couldn't round up enough private investors to finance a slate of movies. "When he isn't seducing you with that quiet charm, he's bouncing you off the walls," says Eberts.

Perenchio's media empire might be tiny in comparison with the industry's giants, but nobody disputes that it is a gold mine. Disposable income among Hispanics has grown 29% since 2001, to $652 billion last year, double the pace of the rest of the population. Having that demographic as its captive audience has made Univision an attractive takeover target. And Perenchio has had offers. Viacom Inc., for one, would love to own Univision, having watched NBC snap up Univision's chief rival, Telemundo Communications Group Inc., in 2002 for $2.7 billion. Viacom tried to buy Univision two years ago, with an offer said to have been $6.5 billion in stock and debt, but Perenchio rejected it as too cheap. Says Viacom Co-President Leslie Moonves, another of his poker pals: "It's no secret that we're interested in Spanish-language TV. I just don't think Jerry is selling."

Maybe. Maybe not. It's never easy to tell with Perenchio. One thing is certain, though: Any buyer of Univision will feel as though he has been through the kind of prizefights Perenchio used to promote. "The rule about Jerry has always been if he's selling, you shouldn't be buying," says former Viacom President Frank J. Biondi Jr.

It is that style that has made Perenchio among the most successful—and most diverse—of Hollywood showmen. He has been in the business for nearly 50 years, influenced early on by MCA Inc.'s publicity-phobic studio boss Lew Wasserman. Perenchio, the son of a Fresno (Calif.) winery owner, started working his way through college by booking bands at the University of California at Los Angeles,

on he can reach most of the nation's 39 million Hispanics. Here's how:

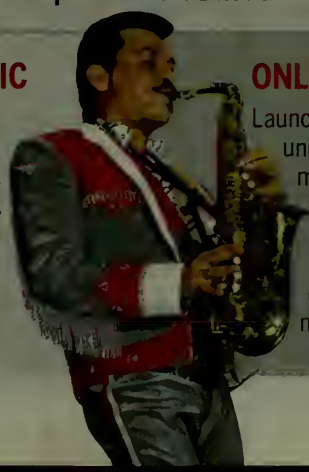
ISION RADIO

operates 68 stations in top-25 U.S. Hispanic . Also four radio stations o Rico. Radio revenues in 84 million (pro forma; acquired mber,

UNIVISION

UNIVISION MUSIC

The group released 35 of the top 100 Latin albums sold in the U.S. during the first quarter. Top artists: Yolanda Perez, Akwid, and Tigres del Norte. 2003 revenues: $113 million.



ONLINE

Launched in 2001, univision.com is the most visited Hispanic site in the U.S., with 12 million unique visits a month. 2003 online revenues: $16 million.

CHARTWELL PARTNERS

Perenchio owns this real estate holding company separately from Univision. Properties include land in Malibu and Riverside County, Calif. It is embroiled in a local controversy over development plans in Malibu. No financials disclosed for Chartwell.

Data: Univision, Merrill Lynch & Co.

where he once escorted Marilyn Monroe to a dance. He went on to represent Hollywood's hottest acts and later arranged some signature sporting events. In 1971 he promoted the Muhammad Ali-Joe Frazier fight in Madison Square Garden, then two years later the "battle of the sexes" tennis match between Billie Jean King and Bobby Riggs. Each time, he wowed folks with his dealmaking savvy. "He came to us with a payday of $5 million for each fighter, and we were only getting $2 million at the time," recalls Ali's then-manager Bob Arum. "So he doubled the prices at the theaters for pay-for-view and promoted it like a movie premiere."

INSPIRED HUNCH

IN 1985, PERENCHIO and his onetime client, *All In the Family* creator Norman Lear, sold their TV and film company Embassy Communications to Coca-Cola Co. for $485 million. He collected $140 million by buying, then selling, the Loews Cineplex theater chain within a year.

Perenchio's biggest score, though, came with his hunch about Hispanic media. It was the late 1980s, and he was no stranger to the Latin scene, having represented such singers as José Feliciano and Julio Iglesias. At first, Perenchio bought Spanish-language Channel 47 in New York to launch a movie-and-boxing subscription service—but changed his mind when local cable channels beat him to it. But he noticed that ratings were jumping for the Spanish programs at the tiny station. In 1992, he teamed up with Mexico's Televisa and Venezuelan programmer Venevision International to buy five more stations and a small Spanish network for $550 million, a launchpad for what was to become Univision.

Key to the deal was the steady stream of soap opera-like *telenovelas* and soccer games that Univision got from its two Latin partners at insanely low costs. Combined with Univision's shows, such as the hit variety show *Sábado Gigante* and talkers like *Cristina*, Univision became a powerhouse as the U.S. Hispanic population swelled.

The hardball tactics extend to nearly everyone Univision deals with

If executives at Tel figured Perenchio was ply a puppet for Telev powerful Azcárraga fa Perenchio left no doubt he was firmly in ch Univision threatened t Televisa in 2000 whe also tried to deliver its grams independently satellite to the U.S., acc ing to filings. The star ended last year when visa gave Univision a 50% stake i TuTV pay-TV channel.

Univision's hardball tactics exten just about everyone the company business with, say several sources 2000, the company withstood a 32 hunger strike by employees at its Fr TV station, who claimed they were less than their English-speaking cou parts. But starving workers were much of a black eye even for Perenc Univision eventually increased the ployees' pay. Today, the company, w says about 10% of its 4,300 employee unionized, is negotiating with the un at its New York and Los Angeles stati "They're probably one of the worst ployers we ever have to deal with," Dan Mahoney, assistant to the presi of the National Association of Broad Employees & Technicians.

Still, insiders say that Perenchio rew the good years with hefty bonuses, pa $30 million out of his own pocket t years ago. But when the advertising do turn cut Univision's 2001 earnings, his executives took a 10% salary cut. He le most of the daily operations to his ex tives but was himself the architect of s deals as last year's $3.5 billion merger radio giant Hispanic Broadcasting Co

No doubt a help in getting the deal proved in Washington was Perenc loyalty to the Bushes: Over the year has contributed $711,500 to the Presi and his father, says Common Cause hedge his bets, though, Perenc Chartwell Holding real estate company nated $167,667 to New Mexico's Demo tic Governor Bill Richardson, a Hispa Richardson wrote to Democratic mem of Congress to push for the radio deal.

Perenchio has never let on about plans for the future—or when he m retire. For now, he's *el gringo* at the to one of the most valuable media franc es, an old-fashioned Hollywood m riding high on the new America. ■

–By Ronald Grover in Los Angeles, Brian Grow in Atlanta Geri Smith in Mexico

BIO

Andrew Jerrold Perenchio

JOB Chairman and CEO, Univision Communications.

BORN Dec. 20, 1930, Fresno, Calif.

EDUCATION Put himself through UCLA by organizing fraternity parties. Graduated in 1954, when the business had revenues of $500,000.

FAMILY Married the former Margaret "Margie" McHugh in 1987, his third wife. She was an executive producer of *Frida*, starring Salma Hayek (left). Three children, including son John, a record executive and member of Univision's board.

GOING HOLLYWOOD Served three years in the Air Force, joined MCA, then started his own talent agency—representing Marlon Brando, Elizabeth Taylor, and Andy Williams.

POLITICAL ANIMAL In the past six years, he and family members have given more than $1.2 million to a range of candidates—from George W. Bush and Steve Forbes to Al Gore and Ted Kennedy.

MOGUL AT PLAY Worth an estimated $3 billion, he spent $13.5 million in 1986 to buy the former *Beverly Hillbillies* TV mansion. He also owns a Boeing 737. He has given more than $50 million to charity in the past five years.

PRESS-SHY Likes to quote his mentor, the late Hollywood power broker Lew Wasserman: "Stay out of the spotlight. It fades your suit."

Data: *BusinessWeek*

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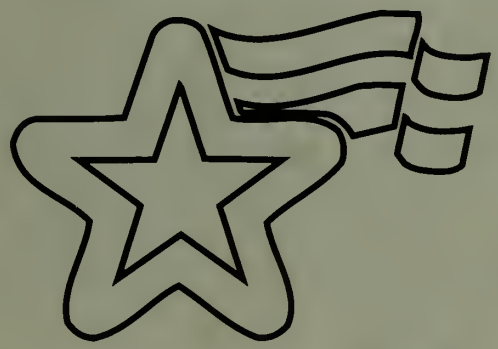
Get a flag from the Capitol. Protect your privacy.
Buy a Treasury note. See about an FHA mortgage.
Enlist in the military. Check on safe travel abroad.
Start a small business. Get info on immigration laws.
File for Social Security.
Check postage rates.
Find military personnel.
Get help on tax issues.
Reserve a campsite.
Buy Savings Bonds.
Find a Federal job.
Get your passport.
Visit a national park.
Apply for a gov't grant.
Report unsafe products.
Trace your family tree.
Register a trademark.
Get Medicare benefits.
Write the President.
Plan for college.
Buy a HUD home.
File your taxes.
Fly the U.S. flag.

Get the answers you can trust from the Federal Consumer Information Center. You've written to our Pueblo, CO address for years. Now you can call us toll-free for answers to your questions about all kinds of federal government programs, benefits and services.



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IMPORTANT PUBLIC HEALTH INFORMATION REGARDING CLEFT LIP & PALATE

What Is Cleft Lip And Cleft Palate? A cleft is a separation in a body structure. Clefts that occur in the oral-facial region often involve the lip, the roof of the mouth (hard palate) or the soft tiss in the back of the mouth (soft palate). Two major types of oral-facial clefts ar cleft lip/palate and isolated cleft palate Babies with cleft lip/palate have a cleft lip which usually is accompanied by cl palate. In isolated cleft palate, the cleft palate occurs by itself, without cleft lip other malformations. The lip or the lip and palate together fail to close in approximately 1 in every 1,000 babies born. Cleft palate occurs alone less often, appearing in approximately 1 in 2,000 babies.

What Causes Cleft Lip/Palate? The causes of cleft lip/palate are not well understood. Studies suggest that a num ber of genes, as well as environmental factors, such as drugs (including severa different antiseizure drugs), infections, maternal illnesses, maternal smoking a alcohol use and, possibly, deficiency of the B vitamin folic acid may be involved

Can Oral-Facial Clefts Be Prevented? While little is known abou how to prevent oral-facial clefts, studi suggest that taking multivitamins contai ing folic acid before conception and during the first two months of pregnanc may help prevent cleft lip/palate and isolated cleft palate. Other studies hav shown that fetuses with certain pre-disposing genes may be at increased risk for isolated cleft palate if their mothers smoke.

Women who are planning pregnancy or who are pregnant should avoid alcohol, which also can cause a number of mental and physical birth defects. Because some types of medications (such as some drugs used to treat epilepsy) have been linked to increased risk of cleft lip/palate, women who take medications for chronic illnesses should check with their doctors before they become pregnant. (They should not, how ever, discontinue their medication witho discussion with their physician.). All preg nant women should use only medication prescribed by a physician who knows of the pregnancy, and get early and regula prenatal care, beginning with a pre-preg nancy visit. Families with a history of cleft lip/palate, isolated cleft palate, or any other condition of which clefting is a part, may wish to discuss the chances o recurrence with a genetic counselor.

Can Oral-Facial Clefts Be Repaired? Surgery often is used to correct cleft lip/palate and isolated cleft palate. The timing and type of surgery depend upon a number of factors, including the prefer ence of the surgeon, the health of the baby and the nature of the cleft.

Other Sources Of Information On Cleft Lip And Palate. In addition to thi valuable information we have tens of thousands of pages of information regarding cleft-related medical journal content, news articles and stories, impor tant cleft resources for patients, their families, and cleft medical professionals, medical students and leading cleft organ izations around the world. For more infor mation on cleft lip and palate please visi the world's largest cleft website: **www.smiletrain.org** or call us at **1-877-Kid-Smile.**

The Smile Train has provided these materials for information purposes only; they do not constitute medical advice.

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ITED BY
RAH R. SHAPIRO

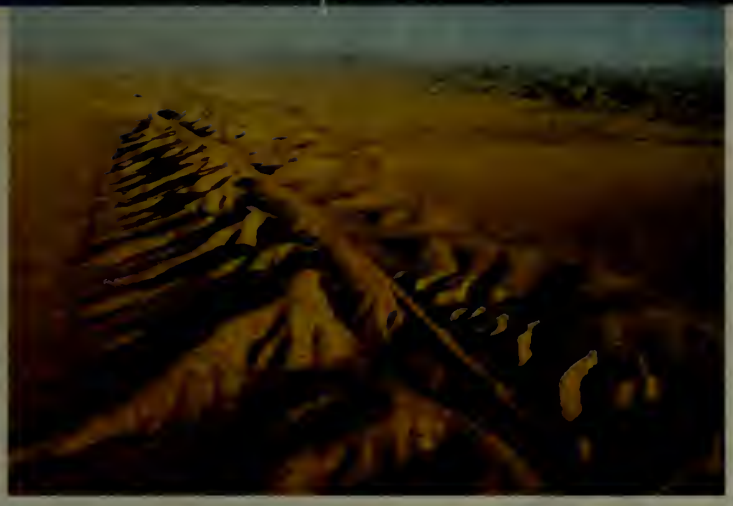
NOVATIONS

f rainforest bugs nd medicinal ponges

For years scientists have sumed that insect attacks plants limit biodiversity in e rainforest. But when searchers from the iversity of Utah and the tional University of the ruvian Amazon studied cal insects interacting with ansplanted trees, they scovered the opposite. ants that devote energy to nding off insects grow more owly—a handicap that metimes prevents them om taking over whole rrains at the expense of less ardy species. The bugs thus elp preserve the variety of ches and habitats, says niversity of Utah graduate tudent Paul Fine.

Drug-resistant malaria, a rowing scourge in many arts of the world, may meet ts match in a humble hallow-water sponge. cientists at L'Institut de Recherche Pour le Développement (IRD) in aris say members of the ponge genus Phloeodictyon, ound near New Caledonia, ontain substances with ntimalarial properties—compounds not found in the deepwater varieties. In nature, says IRD chemist Cécile Debitus, the protective molecules may serve to fight off parasites unique to shallow waters.

–Daryl Hannah



SEISMOLOGY

SIZING UP EARTHQUAKES BEFORE THEY HAPPEN

CITIES CAN PREPARE for earthquakes more effectively and cheaply if they know the maximum potential threat along certain sections of a fault, says Charles Rubin, a professor at Central Washington University in Ellensburg. How can they find out? Rubin and his colleagues dug trenches parallel to the San Andreas Fault northeast of Los Angeles to study large earthquakes that preceded a famous quake in 1857. Examining multiple extinct river beds and measuring how they were cleft, they found that the quake-induced gaps from six large earthquakes all measured roughly 7.5 meters. To get this much slip, each quake must have produced ruptures about 220 miles long, and had a magnitude of 7.5 to 8, Rubin says. He is studying other earthquake zones in Taiwan and the U.S. to test the thesis that quakes along each discrete portion of a fault occur at roughly the same magnitude.

GREEN WATCH

A JUICIER BATTERY FOR ELECTRIC CARS

BATSCAP, A FRENCH company, has a lithium-polymer battery that may inspire auto makers to produce more environmentally friendly cars. The technology has already been proven in smaller devices such as laptops, cameras, and iPods, but BatScap says this is the first such battery that's large enough to power a vehicle.

A unit of conglomerate Bolloré, BatScap spent $85 million and 12 years developing the cell. In an electric car, it would need recharging only once every 120 to 180 miles, BatScap claims, and could go 93,000 miles without needing to be replaced. Vincent Bolloré, CEO of the parent company, says running his battery will cost consumers just 2¢ a mile, saving owners $2,500 a year in gasoline and other costs. He hopes to show it off in an electric car at the Salon Automobile de Genève next March.

The batteries may not fully address one of the biggest complaints about electric cars: poor performance. But the same technology could bring big benefits to gas-electric hybrids, says BatScap.

–Jasper Perkins

ILLUMINATION

BRIGHTER LEDs COULD GIVE LIGHTBULBS THE BOOT

LIGHT-EMITTING diodes are likely to replace old-fashioned bulbs someday. They use a fraction of the power and can last 100 times as long. Yet while they have shown up in car signals and traffic lights, LEDs have so far been too costly to supplant the bulbs and tubes that light houses, offices, and factories.

Cheaper, brighter LEDs may soon make inroads in these spaces, too. A group led by E. Fred Schubert, professor of electrical engineering at Rensselaer Polytechnic Institute, has patented a new design for LEDs using "omnidirectional reflectors" (ODRs) that amplify total light output. Compared with conventional LEDs, they deliver up to twice as much light, says Schubert. The key is the ODRs' ability to reflect photons even at extreme angles. Current designs, Schubert adds, often convert these photons into heat rather than emit them as light.

The new diodes will be cooler and more reliable, and each application will require fewer of them. That, plus the fact that the manufacturing process doesn't change much, should help bring prices down. One LED maker is ready to test the new design, and devices could be on the market in three years. *–Adam Aston*

How Sick Is Your Home?

Indoor air pollution—from mold to radon—presents health risks. **BY STEPHANIE ANDERSON FOREST**

NOBODY WANTS ENVIRONMENTAL hazards such as toxic-waste dumps or smokestacks bellowing gritty plumes in their backyards. But the same sorts of pollutants that come from these sites could be lurking right in your home. Indeed, it can be teeming with allergens, such as dust mites. Carbon monoxide can escape from fireplaces, mold and bacteria often funnel through muck-filled heating, ventilation, and cooling systems, and volatile organic chemicals seep out of paint and carpets. Scientists have also found that even innocuous household products, such as air fresheners, can become dangerous when their fumes react with ozone and create carcinogens, such as formaldehyde. It's little wonder the Environmental Protection Agency (EPA) has deemed indoor air quality one of the top five environmental health risks the U.S. faces today. The agency says indoor levels of pollutants can be two to five times—and sometimes more than 100 times-high as outdoor levels. "Just beca outdoor air is cleaner doesn't ensure t indoor air is cleaner," says Willi Nazaroff, professor of environmer engineering at the University of Calif nia at Berkeley.

You can trace some of the problems indoor home pollution to a noble effor energy efficiency. "We're building tigh and tighter homes and bringing all sc of products and chemicals into them, there's less and less air going throug says Richard Corsi, director at the Te Institute for the Indoor Environment the University of Texas in Austin. tighter home is good from the standpc of conserving energy but bad in terms occupants inside."

That's why some builders are beg ning to take steps to put up houses t are both energy-efficient and healthy.

, as concern has risen over indoor ıtion, initiatives such as Austin Ener- Green Building Program and the rican Lung Assn.'s Health House gram, which credit builders for ad- sing such issues, have taken off, say gram execs. Health House homes cost to 5% more to construct, but they're to 40% more energy efficient.

ı addition, builders such as WCI Communities in Bonita Springs, Fla., are beginning to make a strategy out of building healthier homes. WCI, the largest builder in humidity-laden Florida, recently began offering "green" houses that include both energy-saving and healthful features. So far, they've sold 224 units in their Venetian Golf & River Club in Venice, Fla., with an average price of $360,000.

Those features include a high-efficiency particulate air (HEPA) filtering system that removes 99.97% of airborne particles. The air-conditioning has ultraviolet lights in the ducts so that circulated air is treated to kill mold and mildew. The homes also have wool carpeting and floorings made of bamboo or cork as alternatives to traditional carpeting made from synthetics, which gives off noxious gases. "If you are going to use a carpet, go with a natural carpet like wool," says Jennifer Languell, director of the WCI Green Building project at Florida Gulf Coast University in Fort Myers who helped design WCI's model green home. "The better option is to use area rugs that you can take outside the house and clean."

DEADLY CANDLES

EXPERTS SAY NEW CONCERNS are cropping up every day that could be potential health hazards, including the combination of certain chemicals and the continuing presence of some chemicals in homes years after they have been banned. For example, Corsi, whose University of Texas team has conducted studies on air pollutants, says ozone—the key component in smog—is emerging as an indoor problem. Alone, levels of ozone tend to be lower inside than outside. But so-called oily terpenes from products such as air fresheners, aroma-therapy candles and oils, and cleaning agents can react rapidly with ozone in indoor air to generate secondary pollutants like formaldehyde, a known carcinogen.

Meanwhile, a study released last fall—led by Ruthann Rudel, a scientist at the nonprofit Silent Spring Institute in Newton, Mass., and John Spengler, professor of environmental health at Harvard University's School of Public Health— found long-banned toxic substances such as PCBs and DDT among the contaminants in 120 houses on Cape Cod. The four-year study tested the houses for 89 organic chemicals identified as endocrine-disrupting compounds. EDCs are chemicals

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Information about indoor air quality and respiratory health issues state by state

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cpsc.gov; 800 638-2772
Find numerous publications, including "The Inside Story—A Guide to Indoor Air Quality"

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epa.gov/iaq; 800 438-4318
Everything you ever wanted to know about indoor air quality, from sources to health effects to remedies

that can interfere with human hormones and have been linked to increased rates of testicular and breast cancer, as well as certain birth defects and neurological problems. "One of the things that surprised us was evidence of a pesticide like DDT, which has been banned for more than 30 years, and residuals of a flame-retardant that has been banned for about 20 years," says Spengler, who is also author of the *Indoor Air Quality Handbook*. "Some of these chemicals don't break down easily and can survive a long time in the home."

BEYOND THE SNIFF TEST

CLEANING UP YOUR indoor air can be simple or complicated, depending on the problem (table). Mold requires moisture in order to propagate, so eliminating the source of the wetness—say, a leaky roof or damp crawl spaces—is critical. If you smell mold but can't see it, you can try a moisture meter, whose price may start at around $75. Or call in a professional, for whom the cost will probably range upward from between $150 and $200—depending on how many samples are needed. A lab will analyze samples, and if they're not hazardous, you can usually just clean up the mold and disinfect it with household bleach. If the samples are toxic, then call a pro.

While mold announces its presence, carbon monoxide (CO) and radon do not. Your best bet for CO is a carbon monoxide detector, which sells in home-improvement and other retail stores for as little as $25 to $50. Experts say you should have them installed throughout the house, including in rooms where the fireplace or furnace are located and in or near bedrooms and basements.

Traces of the long-banned DDT are still found in homes today

Things could get a bit more complicated with radon. The EPA says that radon—a colorless, odorless, tasteless gas that occurs naturally in the soil and rocks—is second only to cigarette smoke as a cause of lung cancer. The EPA recommends that all houses be regularly checked for radon, because elevated levels of the toxic substance have been found in every state, with an estimated one out of every 15 homes in the country having indoor radon levels at or above the EPA's recommended action guideline of four picocuries per liter of air (pCi/L). "To the homeowner, they jus like cracks in the fl foundation, but to molecules those are Grand Canyon," say spector Lon Grossm Technihouse Inspecti Bloomfield Hills, Mich

Testing for radon is ple and inexpensive if y it yourself. You can bu kits through the mail hardware stores, healt partments, or other retail outlets. O can hire a so-called radon-mitigatio fessional. But when looking for a ki pro, make sure you choose one that i tified by either the National Environm Health Assn. or the National Radon S Board, experts say. Grossman, who i tified, says to get accurate results, ru test at the lowest living area in the h and with the windows closed. If rado els are above four pCi/L, you can try the problem yourself by sealing crac floors and walls and doing another t it's still high, call in a professional.

Sure, it's unsettling to think abou pollutants that can invade your home you can rest easier knowing ther ways to get rid of them. ■

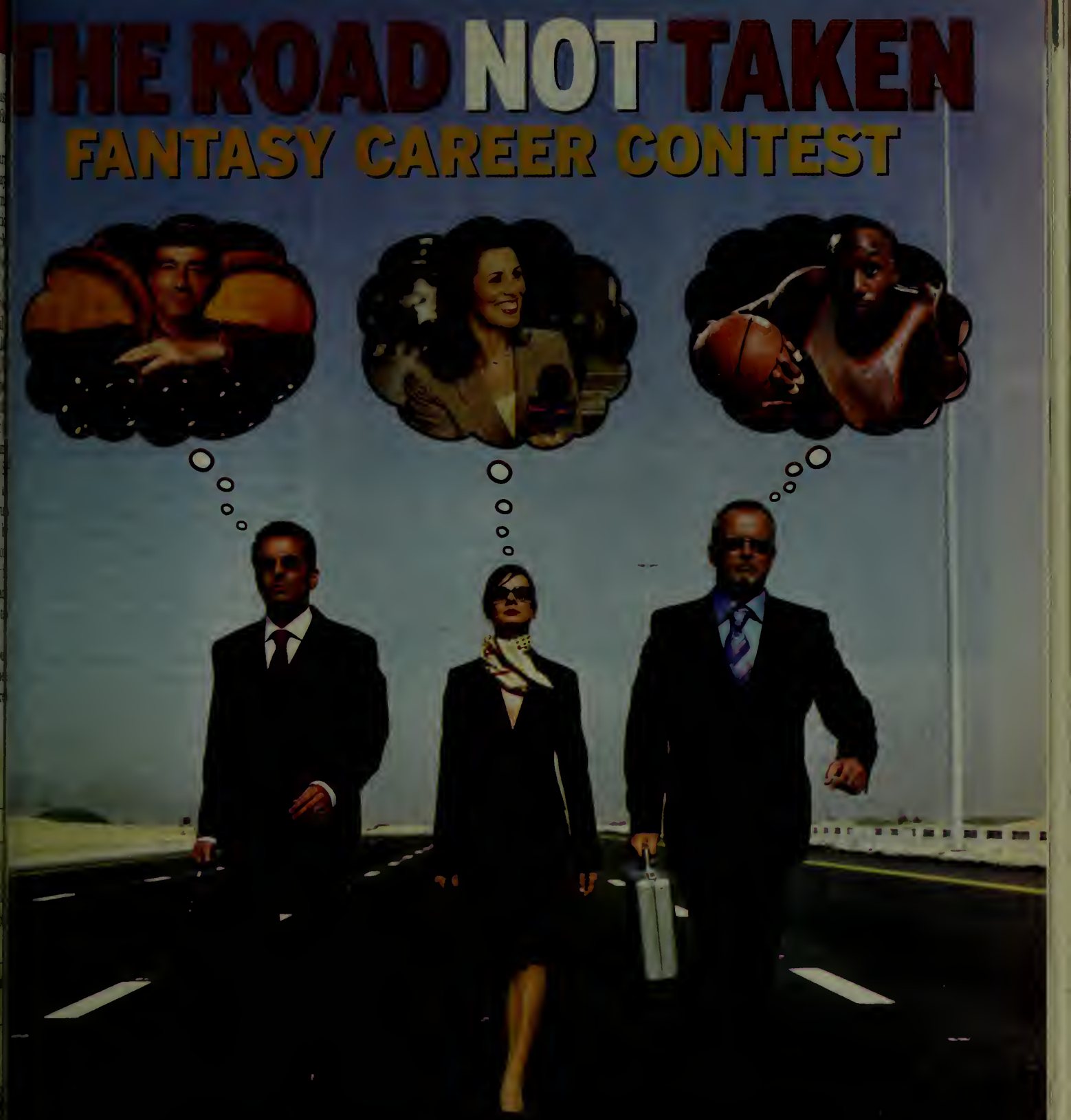
The **Toxic** House

POLLUTANT	HEALTH ISSUES	STEPS TO REDUCE EXPOSURE
ASBESTOS	Long-term risk of lung diseases, chest and abdominal cancers	Leave undamaged asbestos material alone; use qualified contractors if you must remove it
CARBON MONOXIDE	Respiratory infections, headaches, dizziness; death at high concentrations	Keep gas appliances properly adjusted; open fireplace flues; do no idle car in attached garage
DUST MITES/POLLENS PET DANDER	Allergies, asthma, coughing, dizziness,shortness of breath, lethargy	Wash bedding in hot water (above 130° F); use wool carpet or wood flooring; use vacuums with high-efficiency filters
FORMALDEHYDE	Wheezing, fatigue, skin rash, prolonged exposure may cause cancer	Avoid pressed-wood products in cabinetry; use carpet with no formaldehyde content; increase ventilation
LEAD	Impaired mental and physical development in children, kidney damage, hypertension	Use bottled water if drinking water tests positive for lead; don't san or burn off lead paint; cover with wallpaper
MOLD	Allergies, asthma, other respiratory ailments	Install kitchen and bathroom fans vented to outdoors; clean air conditioning and heating equipment; keep basement dry
PESTICIDES	Irritation to eye, nose, and throat; nervous system, kidney damage; cancer	Use nonchemical methods of pest control; don't store, pour, or mix pesticides inside the home
RADON	Estimated to cause about 10% of lung-cancer deaths	Have home tested, get professional advice before carrying out rado reduction; seal cracks in basement floor; ventilate crawl space
VOLATILE ORGANIC COMPOUNDS	Headaches, nausea, kidney damage, fatigue, dizziness	Use nontoxic alternatives to paints, cleansers, disinfectants; never mix household products; use in well-ventilated areas

Data: Environmental Protection Agency, American Lung Assn., Busin

THE ROAD NOT TAKEN

FANTASY CAREER CONTEST



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Outgrowing The Small Fry

Wasatch's new large-cap fund taps insight gleaned from its small-cap experience

WASATCH FUNDS, which manages $9 billion in assets, offers some of the best-performing small-company funds. The big problem is that all of Wasatch's six U.S. diversified funds are closed to new investors. The only way in is through the two-month-old Wasatch Heritage Growth Fund, which invests in midsize- and large-company stocks. It's new ground for Salt Lake City's Wasatch, but many of the stocks are successful companies that have outgrown the small-cap funds. Personal Business Editor Lauren Young spoke with Samuel Stewart, Wasatch's chief executive officer, about the new offering.

Why launch a large-cap fund now?
We aren't opening this fund because we think it's a good time to invest in large caps, although certainly valuations look more compelling. We actually tested this fund for two years with a paper portfolio before we introduced it.

This really isn't about raising money, either. As a firm, we have all the assets we need. The reason we launched the fund is that it has some value added for our existing funds. If we can do this right, we will be better investors. That's bec many of the small companies we inve have bigger competitors out there. more we know about the big compa in a sector, the more we understand smaller companies we already own.

To really understand the small con nies we invest in, we need to research larger, leading companies in an indu A classic example is AutoZone O'Reilly Automotive. O'Reilly is an a motive-parts company that Wasatch invested in for 10 years. But the big gu the industry is AutoZone, so we've been talking to AutoZone managem and constructing earnings models for company for a long time, even though couldn't own it in the small-cap fund.

What kinds of stocks are in the fund?
We invest in companies with strong c petitive positions in markets that have rious headroom. A company must h the ability to increase its earnings or s other important valuation metric by a tor of two over the next five years.

For this fund, we are focusing stocks in the $3 billion-to-$20 bil range. Some of the companies in portfolio are Wasatch graduates—o we owned in our small-cap funds are now getting too big to fit the fu parameters.

We still have Express Scripts, with a billion market capitalization, in som the small-cap funds. The mail-or pharmacy company is one we like, an still seems to be doing fine, but it longer fits the small-cap definition. other kinds of companies we buy are la er peers of companies we already owr

What are some other Wasatch graduat that might go in the new fund?
Medical-device maker Medtronic i company that we used to own, bu grew too large for the funds. Now something we own again in the r fund. It's the same thing with Coun wide Financial. Countrywide is one the bigger mortgage lenders in the U and we've got a lot of small ones in small-cap portfolio.

Do you think we are at the end of the small-cap cycle?
Most people who look at the market small-cap cycles last for six years or and plenty of them will say small caps more expensive. We do recognize that valuations could go against us for a wl in small-cap land. But no matter what market cap is, we want to find a g company at a reasonable valuation. ■

Hidden Valley

ermore, an often overlooked wine region, is a ort drive from San Francisco. BY CLIFF EDWARDS

EVERY FEW MONTHS, IT seems, when relatives or friends parade into the Bay Area, I make the hours-long trek through congested traffic into California wine country. After g out here for five years, you can gine how many times I've toured the a and Sonoma valleys. That's why I ntly was surprised—and only too py—to discover another wine region a stone's throw from San Francisco. ivermore Valley's 26 wineries are len amid suburban tracts and scenic yos and canyons 39 miles south and of the Bay Bridge. Many visitors ugh the area probably are more far with the huge Altamonte Pass dmill farm that helps generate 1% of state's electricity. But rmore is actually one California's oldest e-producing regions. ing back to the 1840s, rmore has played a role in shaping the tation of the state's es. It was here where world first saw over- d irrigation, mechani- harvesting, and roller hing of grapes. Amer- won its first grand e award and a gold medal for wine n two Livermore wineries in 1889 at Paris Exposition. And guess where ifornia chardonnay originated? ghty percent of the chardonnay in Cal- nia is planted to the Wente clone," s Carolyn Wente, a fourth-generation owner of the Wente Vineyards Estate nery in Livermore.

Once a haven for farmers, Mexican se rustlers, and prospectors, Liver- re stands out because of some differ- es from the more popular Napa and oma. A key distinction is its east-west entation that creates a wind tunnel effect, pulling heat from California's fertile Central Valley during the day and cool air from the Pacific Ocean at night. The heat increases grapes' sugar levels, while the cool air helps build acid levels for bolder flavors. The climate, similar to France's Bordeaux region, allows Livermore vintners a few more days a year to keep their grapes on the vine than those in Napa and Sonoma, valleys that have a north-south orientation. "Even one day more on the vine can make a difference in what becomes a great-tasting wine," says Jim Concannon, grandson of the founder of Concannon Vineyard.

BORDEAUX BY THE BAY Jim Concannon (left) makes petite sirah and port

To the uninitiated, Livermore hardly seems the place to grow grapes. The soil is so rocky (Concannon's massive front gate is built from granite boulders taken out of the ground) that you wonder why anyone would bother. Turns out, rocky soil is great for grapes. Vines struggle to get water and produce fewer leaves, so the grapes are more exposed to the sun. The result is wines with great flavors and less jaw-tightening acidity.

A LARGER POUR

CONCANNON, THE FIRST Irish-owned vineyard in the country, prospered for decades as a major producer of sacramental wines for the Catholic Church. In 1961, it created petite sirah, a descendant from the Duriff Rhone grape of France. Infused with hints of blackberries and spices, its strong flavors complement beef and lamb. It sells for about $12 a bottle. Concannon also makes a terrific port, great with chocolate brownies, for $45.

Down the road is Wente, whose biggest claim to fame is chardonnay. Bottles run from $10 to $30. Wente also makes a smooth-tasting merlot under the Crane Ridge Reserve label for $18. In addition to a tasting room, the 2,000-acre property boasts a Greg Norman-designed golf course, a restaurant serving some 400 West Coast wines, and a 1,500-person outdoor concert area.

Since Livermore is less crowded than Napa or Sonoma, winery staff members have more time to talk about the wine. You also generally get a larger "pour," and many of the wineries offer tastings for free. With six more wineries expected to open in Livermore by yearend, I'll be steering more visitors there in the coming months. ■

Techies: A User's Guide

Following a few simple steps can help end your tech-support nightmares. **BY KATE MURPHY**

WHEN MICHAEL Price moved his small consulting business, Octagon Energy Advisors, to a new office in Houston three years ago, he hired a computer-repair technician to reassemble and reconnect his computers. Not only did the fellow fail to get the network up and running, but he also erased the system's hard drive. Says Price: "I ended up having to send it to a data-recovery outfit," and this cost him more than $6,000. Subsequent bad experiences inspired him to take several computer courses at a community college: "I decided it would just be easier if I learned to fix things myself," he says.

Horror stories abound about inept techs—from lost data to smoking hard drives. So you want to be sure whomever you call in for help won't compound your computer troubles. How do you find a qualified repair person?

First, ask your local computer user group for a referral. "User groups are full of enthusiasts and geeks who will know who's good," says Kim Komando, host of a nationally syndicated radio show on technology. You can find a neighborhood group at the Web site of the Association of Personal Computer User Groups (http://cdb.apcug.org/loclist.asp). She also advises searching Google groups before you hire anyone to see if any complaints have been posted on message boards. Computer users are more likely to gripe online than to complain to the Better Business Bureau, notes Komando.

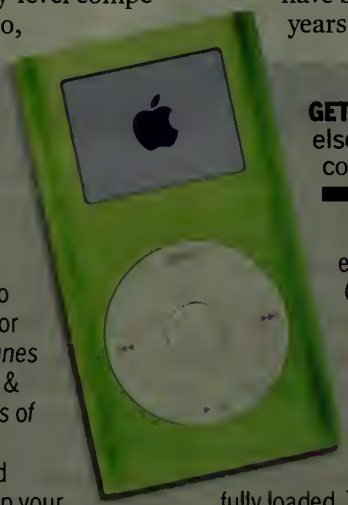
CERTIFIED A+

CHECK WHETHER a repair person is certified by the Computing Technology Industry Assn. (CompTIA). There are various levels of certification, but your geek should have an A+ designation, which indicates proficiency in basic hardware and operating system configuration, diagnostics, and preventive maintenance. "It tells you they have entry-level competency," says Nick Torino, a consultant and president of Geek Tweaks, a computer user club in I tonsville, Pa.

Look for someone who fixes compu full-time. If it's a sideline, you may not prompt service. "I get a lot of calls fi people who have gotten fed up waiting some other repair guy to get time off fi his real job," Torino says. And mo lighters may not be up to date with rapid changes in technology. Experie matters, too. Look for technicians w have been in business for at least years and have verifiable referen

MUSIC PLAYERS

iPod Illiterate?



GETTING HELP Let someone else transfer your CD collection onto your new toy

Is the thought of loading your CD collection onto that little white box called the iPod enough to scare you back to vinyl? You aren't alone. As Apple Computer's popular MP3 player becomes a mainstream must-have, it's only natural that the ranks of techno-deficient iPod owners will continue to grow.

And where there's a demand, someone is always ready to help. A slew of books and services has popped up to take the intimidation factor out of the iPod. *iPod & iTunes for Dummies* (John Wiley & Sons, $16.99) and *Secrets of the iPod* (Peachpit Press, $19.99) offer easy-to-read explanations for setting up your iPod, loading it with songs, and managing your music files.

If you'd rather have someone else do the work, for $1.50 per CD, LoadPod (loadpod.com) will send a professional consultant or tech-savvy college student to your house to pick up your iPod and CDs and return them to you within five days with the iPod fully loaded. The service, an offshoot of the popular iPodGarage.com site, is available in 33 states and Washington, D.C.

(TOP) ILLUSTRATION BY CARLOS APONTE

xpect
pay
nywhere
om $50
$150
n hour

Expect to pay anywhere from $50 to $150 per hour. Ask if there is a minimum charge in case your problem is fixed with a couple of key strokes.

Whether a tech makes house calls or has a shop, the tools of the trade uld include a bootable disk, virus tware, and diagnostic programs. nna Matthews, assistant professor of nputers at Clarkson University in sdam, N.Y., says another good sign is our tech wears a static wrist guard to p from zapping your CPU's innards en opening the case. Even better, she s, is if the person first safeguards a with an external backup device.

Be leery of anyone who uses incomhensible techno-babble. "Good hs should be willing and able to tell what your problem is and how they going to fix it," says Torino. You also ed to help out your geek by writing wn verbatim any error messages u've received and exactly what you re doing when your computer started sbehaving. "That will save at least 30 nutes in troubleshooting," he says.

Finally, you should get a minimum -day guarantee for software fixes, 120 ys for network solutions, and 6 to 12 nths for anything hardware related, pending on whether you paid for new mponents. And the repair person ould have insurance to pay for ishaps like what happened to Price in uston. Computers are just like anying else you have repaired. You have a ght to expect quality assurance. ■

nother service, RipDigital digital.com), will copy your CDs an MP3-packed data DVD but leaves Pod-loading to you. RipDigital charges nd $1 per CD, with lower rates for bulk rs. Unlike LoadPod, which operates ugh house calls, RipDigital requires omers to ship their music collection FedEx.

pple won't load your iPod for you, but can stop by the "Genius Bars" at its l stores, where the bewildered can get from an expert. Detailed manuals and port are also available from apple.com. ou can call the tech-support hotline, just n the old days. *–Seth Porges*

This Drop-Top Raises the Roof

BMW's brand-new 6-Series convertible is powerful, elegant, and eye-catching. BY LARRY ARMSTRONG

UPSCALE CONVERTIBLES are bound to be conspicuous, and BMW's brand-new 6 Series is no exception. The 2004 645Ci convertible, the $76,995 drop-top version of the 645Ci coupe, is a big car in the Grand Touring tradition: elegant, powerful, luxurious. And it has the requisite backseat which, if not very accommodating to passengers, is at least a space to stow extra luggage.

I'm surprised at what an eye-catcher it is. Many BMW enthusiasts are grumbling about the styling of the new BMWs, the 7- and 5-Series sedans. They especially don't like the high rear end. But during the recent week that I drove the 6-Series ragtop around Los Angeles, car-savvy Angelenos loved it. They threw me a thumbs-up, they honked, and they cranked down their windows to chat.

The car comes with a 325-horsepower V-8 that's remarkably smooth and quiet. It propels the car from 0 to 60 mph in less than six seconds and, in fact, you can feel a similar acceleration even at highway speeds. My car had BMW's six-speed Steptronic automatic transmission; you can shift it manually if you want. It's rated for 21 miles per gallon in combined city and highway driving. Or you can also get it with either of two different manual transmissions. Those will boost performance slightly, but they trim the fuel economy enough that you'll have to pay a $1,300 gas-guzzler tax.

The car's ride is pure BMW. It's taut, but not at all harsh. The steering is quick and precise, and an active roll-stabilization system keeps the car on an amazingly even keel when you're going fast around corners. You can raise or lower the soft top at the touch of a button; it takes about 30 seconds. The rear window is vertical and works as a wind blocker when the top is down. You can lower it for ventilation when you're driving with the roof in place.

A THUMBS-UP
Sinuous beauty

While BMW has simplified its much-criticized iDrive, the menu-driven system that controls climate, communications and entertainment functions, it's still too complex and distracting. I had to get out the owner's manual to set the clock ahead an hour and, even then, it took me three tries. You have to go through four operations to find a radio station. What's wrong with the usual row of buttons?

When it comes to pure driving fun, though, it's going to be hard to beat this car. Get in, lower the top, and you'll see what I mean. ■

EDITED BY TODDI GUTNER

BEVERAGES

Not Mom's Iced Tea

YES, THEY'RE READY-TO-DRINK iced teas, but they're not like Nestea. The newest teas in single-serve plastic bottles come in exotic black, green, oolong, and white varieties, use little or no added sugar, and reject artificial flavors and preservatives.

Honest Tea in Bethesda, Md., is putting its most popular glass-bottled organic teas into 15.5-oz. wide-mouth plastic bottles. The four kinds are "just a tad sweet," as the label says, and include Lori's lemon (a black tea), green dragon (a green tea), peach oo-la-long (oolong), and caffeine-free Black Forest berry, an herbal infusion.

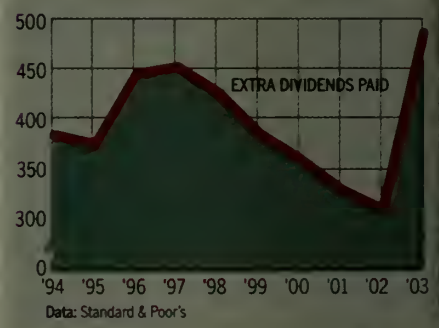
Two other tea makers skip sweeteners entirely. Organic purveyor **The Republic of Tea** in Novato, Calif., is offering 12-oz. minaret-shaped bottles in nine flavors, including ginger peach decaf, raspberry quince, and orange blossom. **Revolution Tea,** a Tempe (Ariz.) maker of loose and bagged tea, is launching its White-T line of white teas in stark white, 12-oz. bottles. They come in Key lime, tangerine, raspberry, and blackberry. Priced from $1.49 to $2.29 a bottle, the new teas are popping up everywhere, from corner delis to country clubs. *–Gerry Khermouch*

INVESTING

A BANNER YEAR FOR EXTRAS?

IT WOULD NOT BE A REACH to say that **Microsoft's** $32 billion extra dividend, be paid on Dec. 2, could exceed all suc extras ever granted. More typical is CI $2 special dividend announced on Jul 22. For CDI, a small staffer-and-out-sourcer, the payout is $39.2 million. Cyclical companies sometimes take th route instead of raising the regular quarterly dividend, says Joseph Lisant editor of **Standard & Poor's** newsletter 7 *Outlook*. This way, they can avoid cutt the dividend if business slumps.

The number of extras is rebounding after a long slide (chart). Through Jun 30, payouts hit 154, up from 127 in the same period last year, says S&P. You can't tell what kind of year it will be fo extras until Christmas. Last year, 197 were announced in December.



GADGETS

DRIP DRY AND DRIVE

USUALLY, IF YOU DON'T wipe your car by hand after a wash, you'll end up with a clean car covered with white spots from the minerals in the water. But **Mr. Clean AutoDry**, a $20 soap-and-rinse dispenser that hooks up to a garden hose, uses replaceable filters similar to the disposable filters for faucets and pitcher water purifiers to give your car a final rinse. Water sheets off, and the car air dries with no white residue.

TIME OFF

Looking for a cool vacation? How about an ice-breaker adventure to the Arctic? Celebrity Cruises (866 973-8466) and Quark Expeditions are offering 14-day trips (11 nights on board) leaving from Ottawa (from which you fly to the embarkation point) on Aug. 11 and Sept. 3. They're slashing fares 25% to fill cabins, starting at $6,750 per person. If the Arctic dates don't work, discounted Antarctic cruises (11 nights on board) sail on Oct. 25 and Nov. 5 from southern Argentina. *–Michael Eidai*

BY ROBERT BARKER

The Key Word In Google's IPO: Risky

ogle reminds me of my sadly departed nd George. He had a rollicking laugh, stly when aimed at himself. I hear it v, recalling how George, no fan of tball, once hit me up for a few quips oss into the chatter at a Super Bowl ty. George didn't care who won the ne; he just wanted to have fun.

his is my sentiment exactly toward Google, the Super of initial public offerings. Operator of the Internet h engine that everyone loves to love, Google is set early igust to auction 9% of its equity at $108 to $135 a share. oogle's reckoning, that indicates a stock-market value of billion, or $36.2 billion, or anywhere in between. By my ning, that gaping spread says one thing: Don't bother to n this shot-in-the-dark IPO. Bet on this much, though: won't be able to avoid the hoopla as Google's IPO nears. a Googlish spirit of sharing information toward the monweal, here are some ideas to take along to the party.

epare to drop lots of first names. Google's pectus is unusual in many ways, not least s habit of referring to founders Sergey Brin Larry Page and to CEO Eric Schmidt by name. You can impress others by tioning the name Gil, as in Gilad Elbaz, co-der of Applied Semantics, a developer of ne advertising software that Google bought year. Gil is now a Google worker, albeit a y rich one. He owns 1,046,834 class A gle shares. With a 2.8% stake, he'll likely he largest single class A holder after the , into which he's not planning to sell.

on't mistake Sergey and Larry for Warren. In a r to prospective investors, Larry emulates Berkshire Hathaway CEO Warren Buffett, citing the need for long-term focus and the foolishness of quarterly earnings guidance. You might note, though, that he strays by also suggesting Google's two classes of stock are akin to Berkshire's. Google class A, which is being sold in the IPO, gets one vote per share; class B, Larry and Sergey's variety, gets 10 votes. The point, Larry says, is to keep control of Google with those who have its best interests at heart. Yet when Berkshire sold its class B stock in 1996, its explicit goal was different. It aimed to preempt plans by Wall Street to rake in fat fees by repackaging Berkshire's high-priced stock—$36,000 a share back then—into smaller slices for mom-and-pop investors. Berkshire's directors and officers hold 42% of the vote; Larry, Sergey & Co. will hold 60% of Google's votes.

» Remember how fleeting are Silicon Valley's seasons. If Googlers strike you as cocky, you need only remind them of the last occupant of their headquarters in Mountain View, Calif.—Silicon Graphics, the toast of the Valley a very few years ago. A miscalculation here, a slow product cycle there, and SGI's 1995 stock-market value of $8 billion shriveled to $430 million today. SGI last year sublet its home to Google and now operates a mile or so away in 59% of its old space.

» Don't be evil. As every Googologist knows, avoiding evil plus "making the world a better place" are two management precepts Sergey and Larry swear by. How might you apply them at home? Unless you consider Powerball a sound portfolio strategy, shun the IPO. Instead, as my friend George would have done, look on it as a chance to have a ball: Throw a Google IPO party. Invite friends over, tune in CNBC, mix up some Google Cocktails (box). Start a pool to bet on Google's ultimate IPO price. Agree that the winner must give the pot to his or her favorite charity. Now, how's that for making the world a better place? ■

E-mail: rb@businessweek.com

Google Cocktail

In a shaker, mix:
- **2 jiggers of any Russian vodka**
- **Ice**

Stir gently, then quickly pour half of mixture into one glass. Save it for a Google insider.

Next, add to shaker:
- **9 jiggers of water**
- **1 sugar cube**

Shake until frothy.

Serves 10 investors at the IPO.

BY GENE G. MARCIAL

THESE DAYS ALBERTSON'S IS LOOKING A LOT MORE APPETIZING

NEW CANCER TREATMENTS MEAN BRISK SALES AT MGI PHARM

WITH AUDIBLE, FOLKS ON THE GO CAN LISTEN TO THE NEWSPAP

Albertson's: A Tasty Bite

ALBERTSON'S (ABS) supermarkets haven't been on investors' shopping lists for years. After hitting 67 in 1999, shares have languished between 20 and 30—and are now at 24. Stiff competition, exacerbated lately by Wal-Mart Stores' entry into groceries and a long West Coast strike, has sunk the earnings. No major Street analyst has a "buy" on the stock, but Kevin Lane of investment outfit Redwood Technimentals Research, which owns shares, sees a turnaround ahead. Store closings, cost-cutting, and smart acquisitions "have begun to show up in results," he says. Albertson's recent purchase of Shaw's Supermarkets, a 200-store chain, gives it a "strong footing in New England," says Redwood's Joseph Phillips. Albertson's owns 2,300 stores in 31 states—and runs 228 gas stations. With Shaw's, Phillips sees earnings of $1.49 a share in fiscal 2004 (ending Jan. 31, 2005) on sales of $38.1 billion, and $2.11 on $39.3 billion in 2005. Lane says the "long decline has built a multi-year base that suggests a bottom is in place." Albertson's is a good long-term play, he adds, and should rise to 51 in 12 to 18 months.

MGI Pharma Has Just What Patients Need

TINY MGI PHARMA (MOGN) which focuses on cancer, is catching the Street's eye. Its first major drug, Aloxi, an injection to prevent chemotherapy-induced nausea and vomiting, is on fire in a $1.5 billion market—turning MGI into a moneymaker. O.K.'d by the Food & Drug Administration in early 2003, Aloxi posted better-than-expected sales of $37 million in the second quarter alone, prompting analysts to ramp up their estimates on MGI. "We are encouraged by Aloxi's performance," says Christopher Raymond of securities firm Robert W. Baird, who rates MGI "outperform." Because of Aloxi, he lifted his 2004 earnings estimates from 26¢ to 48¢ a share, on projected sales of $187 million. Aloxi alone will account for $153 million, he figures, higher than MGI's own forecast for Aloxi of $140 million to $150 million. For 2005, Raymond sees earnings of 84¢ on $280 million. Another MGI drug, Salagen Tablets, for radiation-induced dry mouth in patients with head or neck cancer, accounted for 67% of 2003's sales of $49 million, which included licensing fees. MGI has inked a pact with Alpharma to market its pain drug, Kadian. In MGI's pipeline is Irofulven for prostate cancer. David Maris of Banc of America Securities rates the stock, now at 26, a buy, with an upside of 37 in a year. He notes the Alpharma deal will bring "rewards with little risk."

Audible Is Where Readers Could Be Headed

BUSY PEOPLE WITH scant time for reading can lis to audio editions of *Scientific American*, Bill Clinto book *My Life*, or even the *Wall Street Journal* thro AudibleReady portable audio players. Audible (ADBL) i Web's largest provider of the spoken word for downloa playback—on PCs, CDs, or Audible's mobile devices. As pure play on the "digitalization of traditional media, Au profits from the rapid adoption of audio players such as Apple Computer's iPod," says Mark Argento of ThinkEq Partners, who rates Audible "overweight." It offers con through its Web site, Audible.com, or Apple's iTunes se The service is marketed through partnerships with retailers such as Amazon.com and manufacturers like Apple, Sony, and Microsoft. Users subscribe to Audible's services, or order "à la carte" content, which includes 50,000 hours of programs. Subscriptions go for $19.90 a month for two books or $14.95 for one book plus a newspaper or magazine. The Old Testament runs $120. Audible has signed up with 165 publishers. Mark May of investment firm Kaufman Brothers figures Audible will earn 10¢ a share on sales c $31 million in 2004, and 40¢ on $44.1 million in 2005. says Audible, trading at 11.45 on July 28, will hit 15 by mid-2005. ■

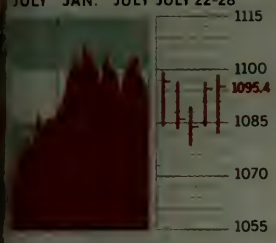
BusinessWeek online Gene Marcial's Inside Wall Street is posted a businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays. See Gene on Fridays at 1:20 p.r EST on CNNfn's *The Money Gang*.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor firms hold positions in the stocks under discussion. Similarly, they have no inves banking or other financial relationships with them.

Personal Business Figures of the Week

OCKS

S&P 500
JULY JAN. JULY JULY 22-28



MMENTARY

pite good earnings from such e-caps as American Express Schlumberger, stocks ggled. And with sparse new nomic data to focus on, stors were left with little to le them. The NASDAQ set a -to-date low on July 26 as sell-off continued in tech cks. The Dow and S&P 500, ever, fared better, ending the k in the black.

Bloomberg Financial Markets, Reuters

U.S. MARKETS	JULY 28	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1095.4	0.1	-1.5	9.9
Dow Jones Industrials	10,117.1	0.7	-3.2	9.2
NASDAQ Composite	1858.3	-0.9	-7.2	7.1
S&P MidCap 400	571.0	-1.4	-0.9	15.0
S&P SmallCap 600	274.8	-1.3	1.6	18.8
Russell 3000	617.4	-0.2	-2.0	10.0
SECTORS				
BusinessWeek 50*	629.2	0.7	1.1	8.3
BW Info Tech 100**	322.9	-0.1	-7.9	2.4
S&P/BARRA Growth	537.2	-0.4	-3.4	6.6
S&P/BARRA Value	554.2	0.6	0.4	13.3
S&P Energy	256.0	0.8	14.2	33.9
S&P Financials	374.1	0.6	-1.5	7.6
S&P REIT	118.2	-3.0	2.1	14.7
S&P Transportation	197.5	-1.2	-2.2	10.4
S&P Utilities	120.5	-0.4	1.8	13.9
GSTI Internet	139.1	-1.4	-3.9	3.8
PSE Technology	660.5	-0.4	-5.3	10.8

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	JULY 28	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1125.1	-3.2	-4.6	15.9
London (FT-SE 100)	4356.2	-0.5	-2.7	5.0
Paris (CAC 40)	3575.9	-1.7	0.5	13.0
Frankfurt (DAX)	3807.2	-1.8	-4.0	11.4
Tokyo (NIKKEI 225)	11,204.4	-2.0	4.9	13.9
Hong Kong (Hang Seng)	12,320.3	-0.6	-2.0	20.8
Toronto (S&P/TSX Composite)	8356.3	-1.2	1.6	14.7
Mexico City (IPC)	10,090.6	1.0	14.7	38.0

FUNDAMENTALS	JULY 27	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.70%	1.67%	1.65%
S&P 500 P/E Ratio (Trailing 12 mos.)	19.8	20.7	29.1
S&P 500 P/E Ratio (Next 12 mos.)*	16.0	16.1	17.0
First Call Earnings Revision*	-0.30%	-0.25%	6.51%

*First Call Corp.

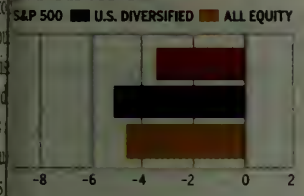
TECHNICAL INDICATORS	JULY 27	WEEK AGO	READING
S&P 500 200-day average	1106.1	1104.6	Negative
Stocks above 200-day average	48.0%	58.0%	Neutral
Options: Put/call ratio	0.77	0.79	Positive
Insiders: Vickers NYSE Sell/buy ratio	3.57	3.66	Negative

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Steel	8.3	Steel	87.0
Tires & Rubber	7.0	Internet Software	82.4
Intgrd. Telecomms. Svcs.	6.9	Oil & Gas Refining	78.0
Oil & Gas Exploration	5.1	Tires & Rubber	61.0
Restaurants	4.9	Fertilizers & Ag. Chems.	58.6

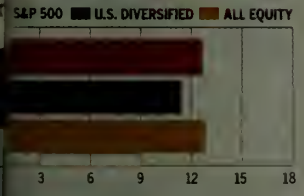
WORST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
IT Consulting	-26.3	Health-Care Distributors	-24.3
Health-Care Distributors	-25.1	Semiconductor Equip.	-21.5
Instrumentation	-17.9	Airlines	-20.4
Semiconductor Equip.	-17.2	IT Consulting	-16.4
Internet Software	-16.2	Biotechnology	-12.1

UTUAL FUNDS

WEEK TOTAL RETURN
EK ENDED JULY 27



-WEEK TOTAL RETURN
EK ENDED JULY 27



: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Latin America	2.8	Natural Resources	38.1
Natural Resources	0.8	Latin America	30.9
Real Estate	0.2	Japan	28.5
Utilities	-0.3	Diversified Emerg. Mkts.	23.2
LAGGARDS		**LAGGARDS**	
Technology	-12.7	Technology	3.3
Small-cap Growth	-8.9	Health	3.5
Japan	-8.6	Large-cap Growth	6.4
Health	-7.8	Domestic Hybrid	8.4

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Rydex Dynam. Vent. 100	16.1	State St. Rsch. Gl. Rs. B	59.2
ProFunds UltSh. OTC Inv.	16.1	ProFunds Energy Usr. Inv.	56.7
ProFds. USh. Sm. Cap Inv.	15.7	iShares MSCI Austria Idx.	56.2
ProFds. USh. Mid Cap Inv.	9.4	U.S. Glbl. Accde. E. Eurpn.	55.2
LAGGARDS		**LAGGARDS**	
ProFds. Smicdr. Ultsr. Inv.	-24.6	Ameritor Investment	-31.6
Reynolds	-23.9	Grand Prix A	-28.2
ProFds. Intnet. Ultsr. Inv.	-22.6	Thurlow Growth	-24.9
Firsthand Tech. Innovators	-21.6	ProFunds UltSh. OTC Inv.	-24.9

INTEREST RATES

KEY RATES	JULY 28	WEEK AGO	YEAR AGO
Money Market Funds	0.84%	0.82%	0.64%
90-Day Treasury Bills	1.45	1.34	0.95
2-Year Treasury Notes	2.74	2.67	1.62
10-Year Treasury Notes	4.59	4.48	4.31
30-Year Treasury Bonds	5.31	5.20	5.25
30-Year Fixed Mortgage †	6.14	5.99	6.23

†BanxQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.92%	4.92%
Taxable Equivalent	5.60	7.03
Insured Revenue Bonds	4.01	5.13
Taxable Equivalent	5.73	7.33

THE WEEK AHEAD

RCHASING MANAGERS' INDEX *onday, Aug. 2, 10 a.m. DT* » The Institute for Supply nagement's July manufacturing ivity index is forecast to have d virtually unchanged at 61%. at's based on the median ecast of economists surveyed Action Economics. In June the lex cooled down to 61.1%.

HICLE SALES *Tuesday, Aug.* » July sales of U.S. and imported hicles likely jumped to an annual rate of 17.3 million, from a multi-year low of 15.4 million in June.

PERSONAL INCOME *Tuesday, Aug. 3, 8:30 a.m. EDT* » Personal income in June probably increased by 0.3%, after a 0.6% jump in May. Consumer spending most likely remained unchanged, due in large part to weak June auto sales, after a 1% gain in May.

FACTORY INVENTORIES *Wednesday, Aug. 4, 10 a.m. EDT* » Manufacturing inventories are expected to have risen 0.1% in June, following a 0.5% increase during May.

EMPLOYMENT *Friday, Aug. 6, 8:30 a.m. EDT* » Nonfarm payrolls very likely swelled by 200,000 positions in July, after a disappointing gain of just 112,000 in June. Factory payrolls probably added 10,000 jobs, after a surprising drop of 11,000 in the prior period. The jobless rate is forecast to hold at 5.6%.

The *BusinessWeek* production index moved up to 223.2 for the week ended July 17, a rise of 11.5% from a year ago. Before calculation of the four-week moving average, the index inched up to 223.1.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/magazine/extra.htm

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This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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Foreign Policy: The Pros and Cons Of John Kerry's Approach

FOREIGN POLICY WILL be front and center in this Presidential election. Not since the Vietnam War has it been so crucial to a campaign. Iraq, of course, is the reason. We now know that the reasons justifying war were largely untrue. There were no weapons of mass destruction. There were no significant ties to al Qaeda. There was no imminent threat. While we did get rid of a bad dictator, the results are hardly encouraging.

Further, the U.S. has paid a high price for its failed diplomacy. By acting unilaterally in Iraq, we failed to amass a multinational military force large enough to secure the occupation. By acting preemptively, we failed to attain legitimacy in much of the world. And in our arrogance, we failed to prepare for the difficult aftermath of an easy invasion.

Democratic candidate John Kerry is proposing a different foreign policy that would be more multilateral, multinational, and pragmatic. His approach is given strong support by the recent 9/11 Commission Report, which faults the Bush Administration for relying on a narrow military response to terrorism without deploying a broad political and economic foreign policy to curtail Islamic extremism (page 30).

Kerry's approach holds promise. But Kerry should realize that a multilateral U.S. foreign policy that aims to make America safe requires multilateral institutions that work, allies that cooperate, and a Middle East foreign policy that at least allows the U.S. to be seen as an honest broker of peace. Right now it is clear that the machinery of the U.N. is broken, the willingness and ability of allies to help is uncertain, and America's disengaged Middle East policy isn't doing much to produce a lasting peace in the region.

The strength of Kerry's approach is that it returns the U.S. to the internationalist path that served it so well during the decades of the Cold War. The battle against Islamic extremism may very well last as long. Allies will be needed to ferret out terrorist cells abroad. With the U.S. mistrusted in the Muslim world, the U.N., troubled though it is, can help in nation-building and providing secular schools for millions of poor children to compete with Islamist madrassas that turn out suicidal fanatics. The need to boost economic growth in places like Pakistan may require sharp cuts in agricultural subsidies, and that can't be done without Europe's help. A pressure on Egypt and Saudi Arabia to democratize will h a greater chance of success if it comes not just from Washington but from Ankara and New Delhi, where Musl already vote in free elections.

Kerry has not yet addressed how he plans to make multilateralism work. The Security Council in particular needs major changes if the U.N. is going to play a signific role in fighting Islamic fanaticism. It failed miserably in stopping ethnic extremism in Bosnia. Kerry has not said much about revitalizing NATO, either. Right now, NATO h little to offer on the battlefield or in the air. If multilaterali is to work, Europe needs to find the resources and the will be full military and diplomatic partners with America. Ke has to promise not only to chat up old allies but also to ur them to take on expensive new security obligations.

America will have a much harder time being persuasive the Middle East. The latest Pew Research Center polling numbers show that even in countries with pro-American governments, such as Egyp Jordan, Lebanon, and Morocco, nearly 100% of th population holds an unfavorable opinion of the U.S. The 9/11 Commission says that America must bat radical Islam as it fights stateless al Qaeda terrorists needs the public support of Arab countries to do both.

Ask executives who travel. Unilateralism isn't a good fit with globalization

Like it or not, the price fo this support is a good faith effort to broker a settlement between Israelis and Palestinians. Here Kerry needs to expl how he is going to get the Israelis and Palestinians back to t negotiating table and to the principles established by the O Accords. Kerry says he would appoint an envoy to get the process going. But it will take a lot more for talks to succeed

The Presidential campaign is taking place at a time whe U.S. military prowess is unsurpassed, yet its actual influen has waned to unprecedented lows. U.S. executives travelin overseas in the past two years could not fail to be shocked the widespread anti-Americanism—and fearful of its possi impact on their companies and the U.S. economy. Unilateralism isn't a good fit with globalization.

John Kerry is offering voters a more traditional multilate foreign policy. But he will have to be more explicit in showi how he can make the machinery of multilateralism work better than it did in the recent past.

August 16

OF THOSE FEES (P.96)

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GLOBAL WARMING

Why Business Is Taking It So Seriously

BY JOHN CAREY (P.60)

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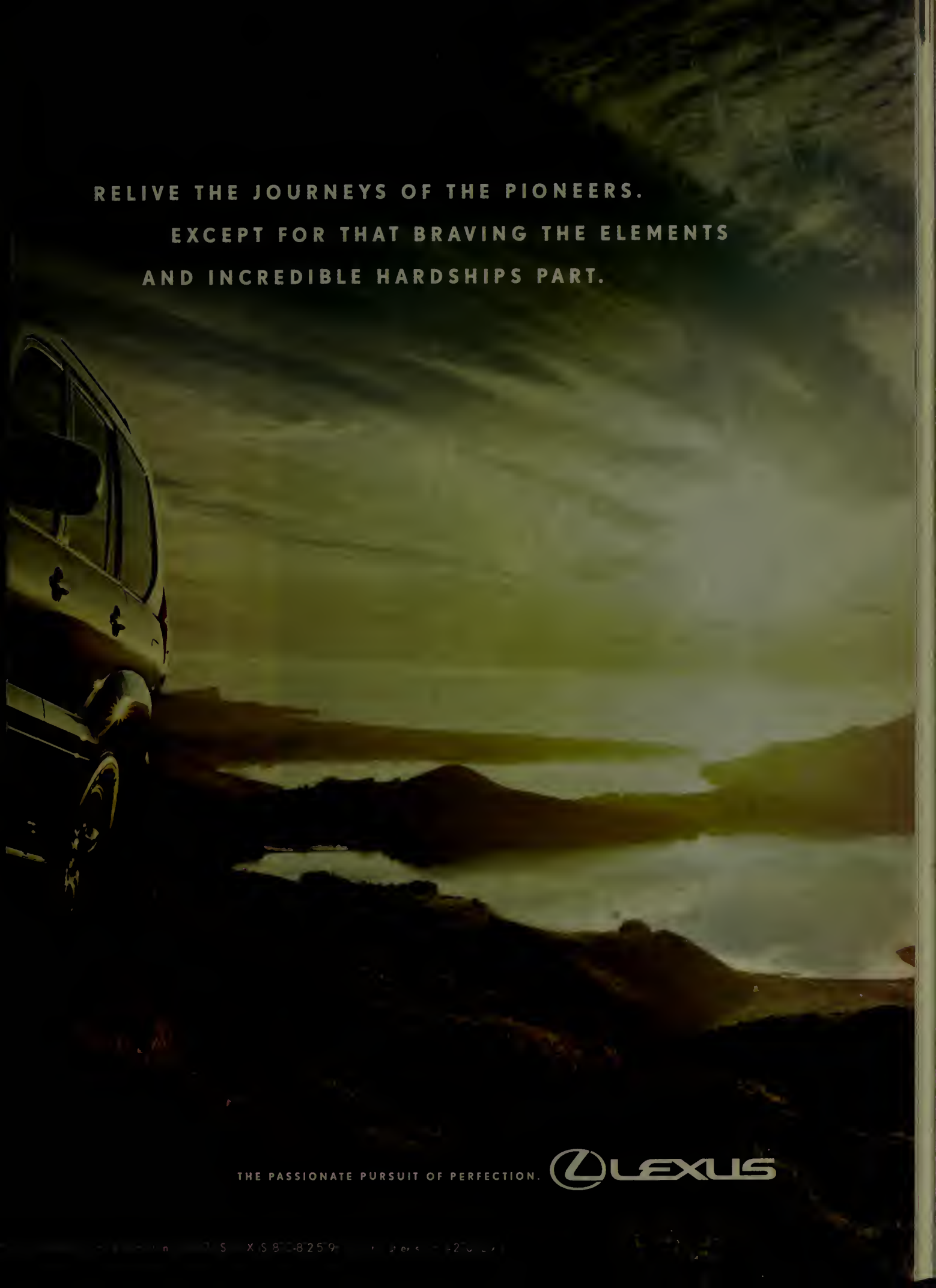
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BusinessWeek

August 16, 2004

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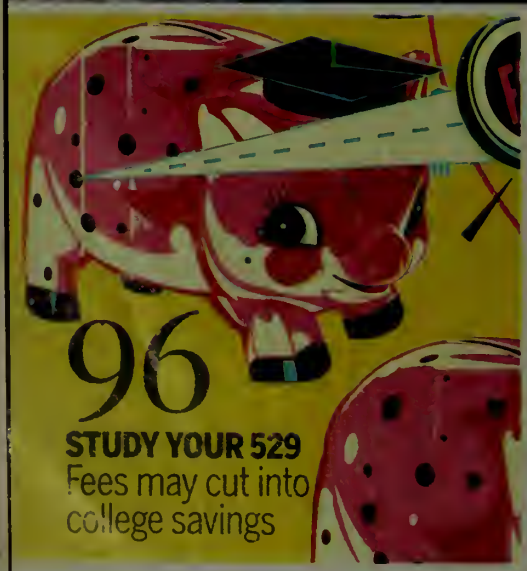
ARCTIC SUMMER
Runoff from the Greenland Ice Sheet makes it clear how rapidly the earth's climate is changing



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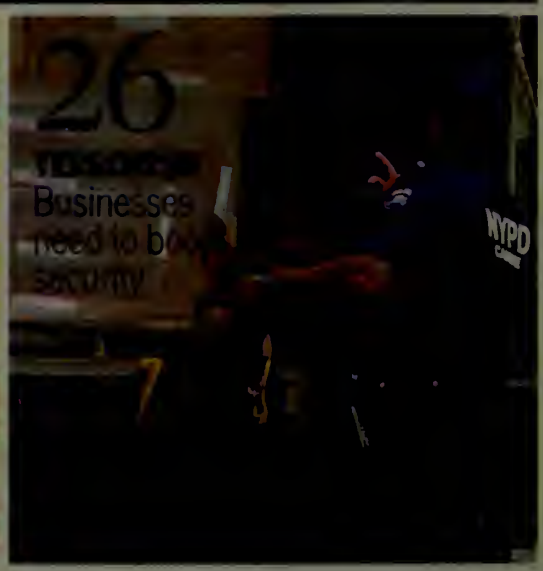
Fees may cut into college savings



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Woody Johnson's Big Cause
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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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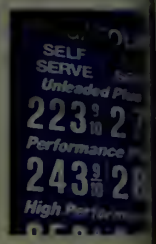
Finding the Fuel for the Next Industrial Revolution



BusinessWeek Chief Economist Michael Mandel says it's time to place the blame for high oil prices where it belongs—on the lack of progress in the development of new energy technology

Checking the White House Budget Ma

The Administration projects that the deficit for the year endin on Sept. 30 will hit $445 billion—$70 billion more than last year. But Bush budget mavens maintain they can cut the deficit in half by 2007. Do the numbers add up?

A Fountain of Youth for an Aging Microsoft

It's hard to believe, but the software giant is pushing 30. Bill Gates & Co. say that innovation will ward off a middle-age growth slowdown. A skeptical Wall Street will be tough to convince

Piracy and Economic National Security

From lost jobs to shrunken profits, intellectual property theft is a major threat to the U.S., says the Justice Dept.'s David Israelite. Now the task force he chairs, with help from industry groups like the RIAA, is going after the pirates

In a Hot Appliance Market, Whirlpool Is Cleaning Up

After a great second quarter, new CEO Jeff Fettig hails global manufacturing and American knowhow as the basis for a shiny future

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UP Front

"We are stunned that RealNetworks has adopted the tactics and ethics of a hacker to break into the iPod."

–from an Apple statement decrying Real's attempt to make its sound files compatible with the popular MP3 player

ED BY IRA SAGER

ARD MOVES

KING A RM SWIPE CALPERS

CALIFORNIA Public loyees' Retirement em has come under fire eing too aggressive in its t for good governance. n July 26, the No. 1 ion fund called in ard Koppes, **CalPERS'** er chief counsel; Ralph tworth, a money ager and shareholder-

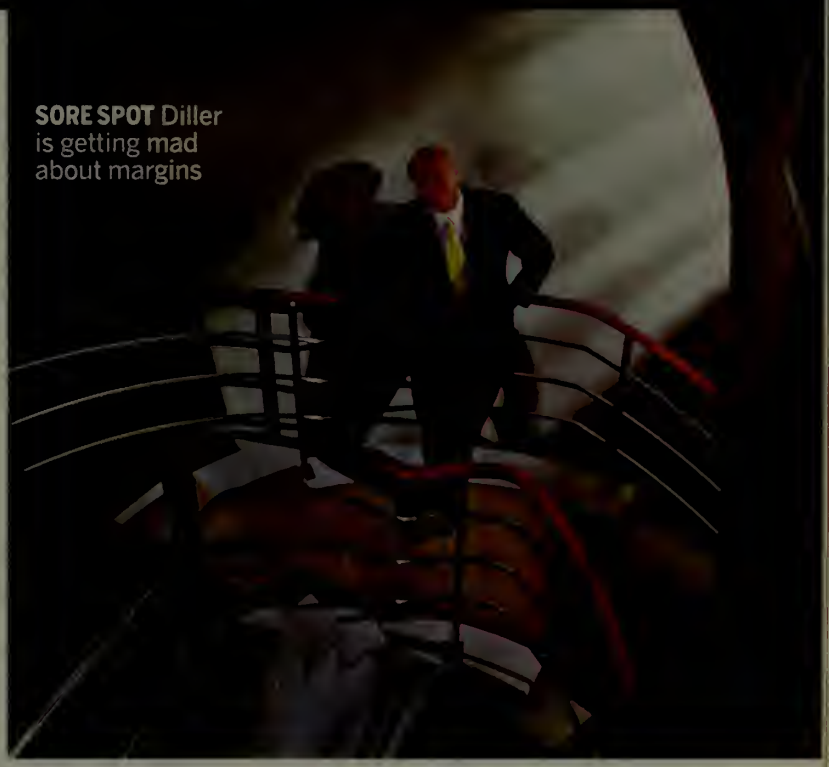
LEVITT The fund has been too zealous

rights activist; and Arthur Levitt Jr., ex-chairman of the **Securities & Exchange Commission,** for their opinions. Their verdict: The fund had overreached.

In a bid to stop companies from awarding consulting work to accountants that also audit the company's books, CalPERS had withheld votes from some 2,400 directors, including investment guru Warren Buffett. CalPERS was also criticized for trying to oust **Safeway's** CEO shortly after a supermarket strike. Many CalPERS directors are union members. "We told them they had too much going on," says Koppes. "We said they need to be more tactical and less political."

Will CalPERS slow down? "We plan on continuing to be aggressive, but look for us to pick our targets more sharply," says spokesperson Pat Macht. Look out.

–Christopher Palmeri



SORE SPOT Diller is getting mad about margins

OFF THE HANDLE

Please Don't Eat the Analyst

TONGUES WAGGED ON AUG. 4 after Barry Diller, the alpha-dog CEO of Web giant **IAC/InterActiveCorp,** had a testy exchange during a quarterly earnings call with **Piper Jaffray** analyst Safa Rashtchy. Diller ranted at Rashtchy, who has argued that profit margins at IAC's **Expedia** and **Hotels.com** sites will narrow as the economy improves and hotel chains gain bargaining power. "You've said it for two years; you've asked us 47,000 times," Diller seethed. "We've said 48,000 times we don't agree with you.... As Judy Garland once said, 'We'll sing all night.'"

In some ways, Diller's right. Margins in IAC's hotel business are indeed up. But revenues came in lower than expected, as growth slowed at Hotels.com and Expedia. Ultimately, Diller's show got panned: **American Technology Research** analyst Mark Mahaney said Diller's "rambling, imploding performance on the conference call" helped fuel a 20% drop in IAC's stock after IAC trimmed its second-half profit guidance. Rashtchy—who actually raised his rating on IAC shares recently—took his browbeating in stride. "He did get pretty upset," Rashtchy says in an e-mail. Is it a coincidence that Judy Garland also had a temper?

–Timothy J. Mullaney

E BIG PICTURE

LAD DAYS Athletes, coaches, and officials Athens' Olympic Village will eat more than million meals. Below is a shopping list:

GENDER WATCH

WAL-MART'S DISCOVERY DISPUTE

WAL-MART STORES is trying to forestall pretrial evidence-gathering in the largest sex-discrimination case in U.S. history, which covers more than 1.6 million current and former female workers. In July 26 court filings, the retailer says a "conservative" estimate would put discovery at 680,000 hours—or 326 person-work-years—to interview witnesses and collect papers at more than 3,400 stores.

DEFENSIVE Holding on to details

So the retailer is trying to freeze discovery, as it waits to see if the Ninth Circuit will consider an appeal of the class-action certification. Wal-Mart contends the effort means 30,000 interviews and a review of 60 million pages of documents: a waste if the court reverses or alters the certification. If an appeal is heard, a decision might not come until next summer.

Plaintiffs' lawyers say Wal-Mart is exaggerating. The first phase would probably involve updating computer info on pay and promotions that plaintiffs already have, while giving details about a recent pay revamp. And even if an appeal succeeds, the info won't go to waste. Should the court deem the current class inappropriate, lawyers may file regional class actions instead. *–Wendy Zellner*

SEX & SYNDICATION

STILL REELING 'EM IN

Skeptics doubted the racy *Sex and the City* would be a draw once sanitized. But six months after Time Warner's HBO retired its most-watched series—starring Sarah Jessica Parker (right)—the edited reruns on TBS have fetched 2 million viewers an episode—more than some of the top-rated shows in syndication. TBS, also owned by Time Warner, pays HBO an estimated $1 million per episode. And DVD sales have rated in the top 15 for TV shows, says Nielsen Media Research. With an expect $300 million from DVD sales and reruns, Sex post-HBO success is mounting. Don't be surprised if a PG version of *The Sopranos* turn up on TBS soon. *–Katie DeWitt*

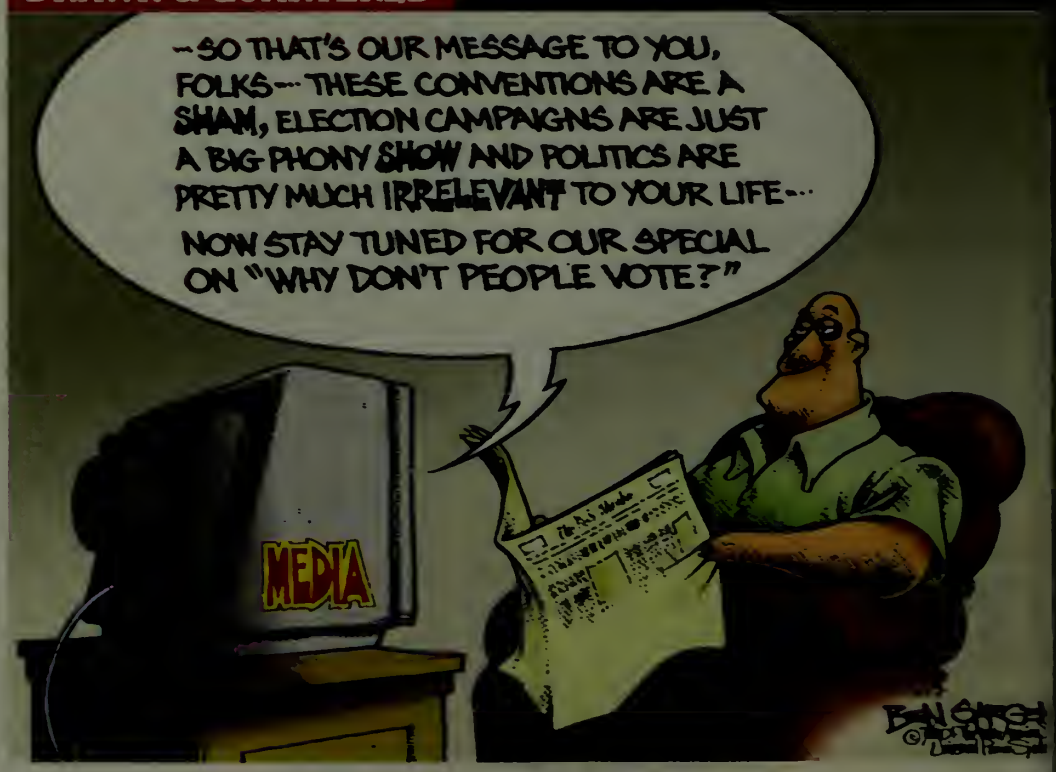
STREET NEWS

THE NYSE MUSCLES IN ON ETF TURF

THE NEW YORK Stock Exchange is focusing more on exchange-traded funds. ETFs, which track companies the way mutual funds do but trade like stocks, have mostly tended to list on the **American Stock Exchange.**

This year, the NYSE has tripled its ETF listings, adding nine iShares—ETFs based on **Morningstar** indexes—and two in-house products. All of them are sponsored by **Barclay's Global Investors.** The **NYSE** has a long way to go: The Amex has 85% of the market, with 138 of the 160 U.S.-listed ETFs. *–Jessi Hempel*

DRAWN & QUARTERED



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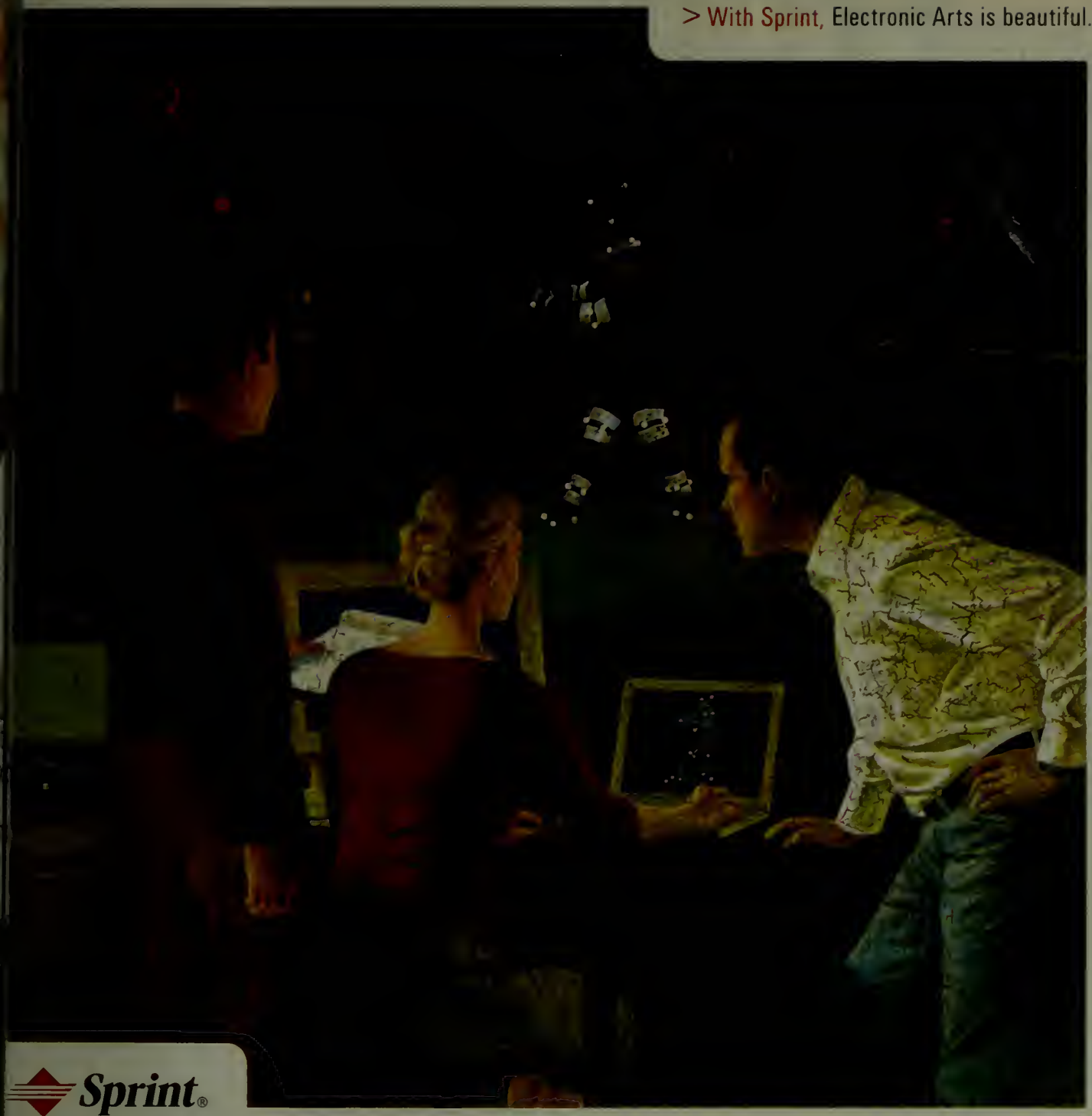

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FACE TIME

WILLIAM NUTI

SYMBOL MOVES ON, AT LAST

When William Nuti gave up his senior vice-president job at Cisco Systems two years ago to be president of Symbol Technologies, he thought the bar-code company had fixed its accounting problems. But he soon found that more wrongdoing was to be uncovered. A probe led in June to Justice Dept. indictments of eight former execs and a $37 million settlement with the SEC. "There was a toxic subculture that had to be dealt with," says Nuti, who became CEO last year.

Now, Nuti, 40, is tending to the Holtzville (N.Y.) company's future. On July 27 he paid $230 million for Matrics, making a play in the inventory-tracking radio-frequency-identification market. But investors balked, and the stock dropped 10%, to $12.50, though it has regained most of the lost ground. Nuti thinks bar codes will coexist with RFID for years, so it makes sense for Symbol to sell both. He faces fierce competition in the RFID arena. But at least his accounting problems seem to be behind him. *–Steve Hamm*

GENDER WATCH

WHO WEARS THE WALLET IN THE FAMILY?

SOME MACHO industries are getting in touch with their feminine sides. **Home Depot** will spend $1 billion this year to add softer lighting and brighter signs to 300 stores in a bid to match archrival **Lowe's** long-standing appeal to women. And **Best Buy,** sparked by the realization that women buy 55% of electronics items, will add personal-shopping assistants in some stores to explain geek-speak such as "megabyte" that some female customers may not grok.

Women may be paid less than men and make it to the CEO suite less often, but the U.S. economy is more and more female-driven. U.S. women control about $3.3 trillion in annual consumer spending and $1.5 trillion more in business outlays, according to management guru Tom Peters' latest book, *Re-imagine!*

What's more, women are expanding their influence: New studies show that women decide 92% of vacation plans, 62% of car purchases, and 52% of home-improvement projects, says Martha Barletta, CEO of consultant **TrendSight Group.** And wom control 51% of America's p sonal wealth, says the Fede Reserve. Even the oil chan is getting a makeover: **Jiffy Lube International** will spen some $8 million to overha shops, put *Vogue* magazine its waiting rooms, and trai its repair staff to explain "transmission fluid" on invoices. Now that's a fem economy. *–Brian Grow*

SOFTWARE WARS

MICROSOFT UPDATES ITS WATCH LIST

MICROSOFT HAS its twin Windows and Office monopolies, but don't tell the brass that the giant doesn't have competition. At its July 29 financial analyst meeting, CEO Steven Ballmer identified the software king's toughest rivals. The annual list is eagerly awaited because invariably one or two of the companies fall away in subsequent years, vanquished by Microsoft or done in by poor decisions. Previous names included **Netscape, Novell,** and **America Online.**

So who's on this year's list? Among consumer companies, Ballmer singled out **Sony** and **Nokia,** along with list newbie **Google** and **Apple Computer,** back after an eight-year hiatus. In corporate software, Microsoft names **IBM, Oracle, Sun Microsystems,** and first-timer **SAP,** which Microsoft considered buying earlier this year. **Linux** is a return listee, and Ballmer has added OpenOffice, an open-source word-processing application. Any guesses which on the list will be the next to go? *–Jay Greene*

THE STAT

24

The percentage of top executives who say that not contributing cash to their company's political action committee could be detrimental to their career. Another 16% are unsure.

Data: CFO Magazine survey of 285 senior finance executives

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CELEBRATING 75

As part of its anniversary celebration, BusinessWeek *is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. In late September, 2004,* BusinessWeek *will publish a special commemorative issue on Innovation.*

Sticking Up for Cities

JANE JACOBS HAD NO formal training in city planning or architecture, or even a college degree. But when this daughter of a doctor and a schoolteacher moved from Scranton, Pa., to New York City in 1938, a job at *Architectural Forum* and marriage to an architect soon blossomed into a lifelong passion for understanding how cities are built and lived in. From her home in Manhattan's bustling Greenwich Village, the opinionated young woman watched with growing disgust as the urban renewal movement that had swept the U.S. after World War II cleared whole neighborhoods in New York and other cities. In their place rose bland Modernist office towers that spawned a kind of urban apartheid, with downtowns set aside for office workers who commuted in from the swelling suburbs, leaving city cores increasingly dark and deserted at night.

The experience prompted Jacobs to write *The Death and Life of Great American Cities*. Its publication in 1961 triggered a profound shift in the way we look at cities. Her premise: Cities are engines of growth whose vitality stems from the variety of activities humans engage in there. They should lively, mixed-use places where people live, work, shop, rai families, and join their creative energies in myriad ways. Cities should be allowed to grow organically; carving then into single-use sections, as the Modernists recommended like thrusting a dagger into their hearts.

Although the so-called New Urbanism movement Jacob helped to spark took years to be widely accepted, her view are now standard thinking among architects and city planners. Her amateur status didn't stop her from attackir the celebrated powers, from Le Corbusier, who wanted to the historic Marais in central Paris (but never succeeded), New York master planner Ro Moses, who built many city highways in the face of fierce neighborhood opposition. In 1960s, Jacobs led activists wl stymied Moses' plans to put a expressway smack through h beloved Greenwich Village.

Jane Jacobs' activism permanently altered urban planning

Nowadays, it's routine for planners to meet with local residents. More broadly, mar officials realize that urban lif can't always be dictated from the top down. The disorganized nature of cities is a natural ingredie of their health, allowing their energy to flourish. the 1990s, Jacobs' ideas about mixing residential and business usage helped fuel the renewed inte in urban cores that has been revitalizing inner-ci areas such as Harlem.

At 88, Jacobs continues to rail against what she sees as sterile planning, particularly in U.S. subur "Never before have normal human beings been consigned to such poverty of imagination and disrespect for function," she lamented in a talk at City College of New York this past May. The subur were essentially created, she said, by "selling out t country for cheap parking." These iconoclastic vie may have been sharpened over the years by her residency in Toronto, where she and her husband moved in 1968 to protect their two sons from the draft during the Vietnam War. The move was to b temporary, but she never left and still uses her per in the north to cast a critical eye homeward. ■

–By Aaron Berns

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> "One can't help but wonder if Scott McNealy was paying attention to the mistakes...made...[at] Digital Equipment Corp."
>
> *–Barry Braunstein*
> *Wellesley, Mass.*

CLEARLY, SUN'S McNEALY KNOWS HOW TO ADAPT—OR MAYBE NOT

IN "SUN: A CEO'S LAST STAND" (Information Technology, July 26), there was no mention of Sun Microsystems Inc.'s successful foray into the legal-and-professional-services market, a potential gold mine for them and a boon for us. Sun has more than met our extensive technology needs with state-of-the-art server technology tailored to our particular firm. With clients and offices throughout the world, it is critical for us to have servers and applications accessible 24/7 and a low cost of ownership. Sun servers replaced hundreds of Windows servers with fewer, scalable, clustered UNIX servers.

Those of us responsible for planning long-term IT infrastructure investment must also be concerned about the financial viability of our partner-suppliers. Just this week, CEO Scott McNealy announced Sun's return to profitability and revenue growth. We are proud to partner with Sun as it steps into the legal field and expect a continued prosperous future.

–Robert F. Ruyak, CEO
Brian Conlon, CIO
Howrey Simon Arnold & White LLP
Washington

ONE CAN'T HELP but wonder if Scott Nealy was paying attention to the takes Ken Olsen made while [McN was decimating Digital Equipi Corp.'s business—the parallels are s ing. Both companies "owned the mar and their CEOs acted with arrogance when the indicators—and their direc ports and customers—called for dran changes to effectively compete ag new, cheaper platforms built on standards, both failed to listen an spond, driving their companies into al extinction. Having worked at DEC ing these times, as well as at Intel Co seems to me they failed to understan basic premise of Andy Grove's phi phy: "Only the paranoid survive."

–Barry Braun
Wellesley, M

DON'T GET YOUR HEART SET ON RETIRING AT 65

"THE BENEFITS TRAP" (Cover Story, 19) accurately depicted a serious prob for the majority of Americans who s from the delusion that they will be ab stop working in their early- to mid-si and live a life of comfortable leisure. fined-benefit plans are fading qui

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RRECTIONS & CLARIFICATIONS

ry's battle plan" (News: Analysis & mmentary, Aug. 2) misstated the title of y adviser Laura D'Andrea Tyson. She is n of the London Business School.

Getting animated" (UpFront, Aug. 9), a rt should have listed an earnings loss of 9.1 million for DreamWorks SKG rather n a profit.

nly one in five private-sector workers w covered by such plans. One in four ers covered by 401(k) plans does not ibute a penny. Social Security and te savings also will be woefully inad- te to support most boomers if they continue to work

e Retirement Guide section of the 26 *BusinessWeek*, however, paints a rent picture. "No need to hit the c button" (Personal Business, July assures us that with a few minor ges in their lifestyles, boomers can e their retirement dreams come using an example of a 46-year-old utive who earns $190,000 a year has about $600,000 in financial as- "Making your money last over the s" uses a fictitious couple who earn),000 per year and have $800,000 ancial assets.

et's put this in perspective. Median ehold income in the U.S. is about 000 a year. Using the Federal Reserve rd's Survey of Consumer Finances, ard N. Wolff of New York University ulates that the median household net th in the U.S. is $73,500. Excluding e equity it is $23,2000.

he vast majority of boomers aren't aring for life after work. In truth, the of universal retirement is coming to an *BusinessWeek* would help shape real- expectations for future seniors by fo- ng on a broader segment of Americans a tiny sliver of the more affluent.

–Edward M. Syring Jr.
Gulf Stream, Fla.

tor's Note: The writer is a former econ- st at Federal Reserve Bank of New k and an ex-chief economist at Marine lland Bank and E.F. Hutton & Co.

THE MATH: THE QUALITY NEW JOBS IS DETERIORATING

"ANOTHER LOOK at those job num- s" (News Analysis & Commentary, 26), Peter Coy takes issue with my clusion that the recent upturn in hir- has been concentrated at the low end he quality spectrum. There is a serious shortcoming to his analysis: It is based on unpublished data taken from the government's smaller and less reliable survey of U.S. households. My conclusions are based on the far more comprehensive and accurate survey of workers on payrolls in business establishments.

The Bureau of Labor Statistics' "active sample" of some 400,000 establishments in the payroll data covers about a third of the total universe of such workers. By contrast, the monthly sample of only 60,000 households covers only 0.06% of the universe of more than 106 million households in the U.S. The data are unpublished for good reason: Much of the granular detail in the 154 job categories Coy has analyzed is simply not statistically significant. Nor are these data reliable enough to seasonally adjust. Coy and other analysts examine trends on a year-over-year, or 12-month trailing, basis. That misses the key aspect of this debate: a decomposition of job trends over the past four months, March to June, 2004.

I stand by my analysis: By industry, restaurants, temporary hiring agencies, and building services were the leading sources of hiring over the past four months. Accounting for only 9.7% of total nonfarm payrolls, these three low-quality segments of the U.S. workforce contributed 25% to the cumulative growth in overall hiring from March to June, 2004. All in all, lower-end industries, which employ 22% of the workforce, have accounted for 44% of new hiring—or twice their fair share—over the past four months.

Contrary to the sub-headline in the *BusinessWeek* article, the BLS is not putting any spin on newly revealed jobs detail by recommending one conclusion over another. That task, according to Coy's reporting, apparently has fallen to the White House's Office of Management & Budget. Now why would they be interested in painting a rosy picture of one of America's toughest problems?

–Stephen S. Roach
Chief Economist
Morgan Stanley
New York

How to reach *BusinessWeek*

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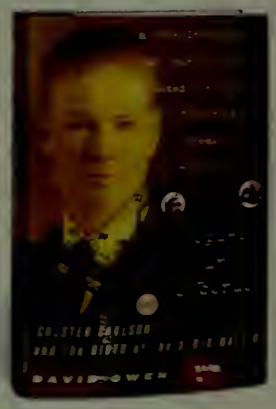
Birth of an Info Tech Miracle

COPIES IN SECONDS How a Lone Inventor and an Unknown Company Created the Biggest Communication Breakthrough Since Gutenberg—Chester Carlson and the Birth of the Xerox Machine
By David Owen; Simon & Schuster; 306pp; $24

The photocopier falls into the category of common things we take for granted, such as air, water, and Google. Walk up to the machine, put your original on the glass, and push the button. The marvelous gizmo has become so tightly woven into our daily lives that we notice it only when it is out of order.

But sometimes, writes David Owen in *Copies in Seconds*, his account of the invention and development of the Xerox machine, it is "interesting to speculate what life would be like if some conspicuous element of it were removed." In his vision of a world without photocopiers, there would be: larger forests, no Pentagon Papers, fewer lawyers, better memories, more secrets, and "a lot less information in general."



Owen, a *New Yorker* staff writer and the author of numerous books, is not the first to tell the tale of the invention of photocopying by Chester Carlson (BW—June 7) and its commercialization by the company that came to be called Xerox Corp. Besides a few books mostly published in the late 1960s and early 1970s, there have been a number of magazine articles on the topic, including one the author wrote almost two decades ago in *The Atlantic Monthly*. But through prodigious reporting and deft writing, Owen paints a fresh and compelling portrait of Carlson. He also offers a dramatic account of the race by a band of engineers and scientists to make a working machine before anyone else did.

Owen begins his story at the beginning. Not Carlson's beginning, in Seattle, 1906—that comes later—but 500 years ago, with the origins of printing. For most people, the high points in the history of duplication go something like this: monks' hand-lettering, the Gutenberg Bible, carbon paper, Xerox. But in truth, great thinkers over five centuries had been trying to solve the puzzle that Carlson finally cracked: how to make an exact replica of an existing document.

The hunt covered many paths, and the searchers included some of the world's finest inventors. Devised along the way were everything from engraving techniques, including lithography—a descendant of which was used to print the magazine you are reading—to Thomas Edison's Automatic Press and Electric Pen, blueprinting, photography, and, finally, the combination of carbon paper and typewriters.

None of these quite fit the bill: With a postwar economic boom came rising demand for a true copying solution. Chester Carlson had found one in 1938, but it took 22 years for his discovery to be turned into a marketable product. That story comprises the heart of Owen's boo

While many doubted that Carlson's process, based on electrostatic charges and photoconductivity, could really work consistently, he remained steadfast. His resolve was rooted in a childhood marked by dire poverty, ailing parer frequent moves, and a loneliness that left him both shy ar independent. For a period after his mother's death, Carlso and his father, who was wracked by tuberculosis and arth lived in a former chicken coop. By the time Carlson enter high school he had become the family breadwinner. "Invention," he is quoted as saying, "was one chance to s with nothing and end up with a fortune."

Absorbing as Carlson's rags-to-riches story is, one of th book's best sections is dominated by others: the dozens of little-known chemists, physicists, engineers, and business who in the 1940s and '50s brought Carlson's patented dev to life. Some, such as engineer Edward Wise, were at Batt Memorial Institute in Columbus, Ohio, which early on sav the potential of Carlson's idea and became its ag Others, such as CEO Joseph C. Wilson, were at Haloid Co., the Rochester (N.Y.) company that la became Xerox and commercialized the inventio These individuals faced an exhausting array of challenges, from figuring out the appropriate op lenses to keeping the device cool so the paper di catch fire. The toner, for example, had to melt fa yet not be so soft that it would smear. It had to b fine powder to create sharp images, but if it was fine, that caused other problems. "The more you understand about xerography," pioneering Xero engineer Bob Gundlach tells Owen, "the more y are amazed that it works."

> "The more you understand about xerography, the more you are amazed that it works"

Owen gracefully convey just how important solvin the engineering puzzle wa Gundlach and the others involved. Racing against t as Carlson's patent ran ou and against the criticism o detractors—the quest beca for many, the defining moment of their careers, if not their lives. If *Copies in Seconds* has a shortcoming it's that it focuses too muc on Carlson and not enoug on these intriguing tinkerers and gutsy businessmen.

Some might argue that, in the Digital Age, the book's topic has become quaint. But in the midst of today's med overload, *Copies in Seconds* reminds us how hard people fought to democratize information—and how quickly we come to take it for granted. ■

–By Nanette Byr

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BWK8/04

BY CLIFF EDWARDS

MP3 Plus Video: Great Idea, Needs Work

Every time I hear the phrase "iPod killer" I'm reminded of poor Elmer Fudd on his constant quest to "kill the wabbit." Rivals such as Rio and Sony have sleeker designs with longer battery life, but nothing so far is close to dethroning Apple Computer's player. Now at least six of the biggest names in portable audio are trying a different tack. They're asking

"What if you could not only fit 5,000 songs in your pocket but 80 hours of video, too?"

Over the past few weeks, I've taken a look at three portable video players from Archos, Creative Technology, and Samsung Electronics. All three see their products as iPods for the video era. None stands a chance, in my opinion, but Archos' $550 AV400 Pocket Video Recorder is the best of the lot.

PACKING A 20-GIGABYTE hard drive and a 3.5-in. liquid-crystal display screen in a 9-oz. unit about the size of a personal digital assistant, the AV400 is a head-turner. It has a cradle and audio-video cables that can stay permanently docked near your home theater system to record TV shows or movies directly off your TV, VCR, or DVD player—making it the first TiVo-like personal video recorder that's portable.

I hooked the AV400 up to my combination DirecTV-TiVo satellite receiver, took about 15 seconds to set the date, time, and channel it would need to record *Dead Like Me*, and went to bed. The next morning the movie was waiting for me to take on a trip. Archos also lets you sync with My Yahoo! TV and calendar functions to automatically set recordings.

Getting music to the player was a snap. Musicmatch software that's bundled with the AV400 lets you encode and transfer music, or you can drag-and-drop music already stored on your PC to the device. Music I transferred in both the MP3 and Windows Media formats sounded good with the supplied headphones and great on a Bose set. You can also download iTunes music from the Mac, but only in the MP3 format.

The AV400's downside? As with all the new portable video players, you need sharp eyes or strong glasses. Even compared to notebook PCs, not TVs, the screens are scrunched. And unlike music, there's very little good, compressed video that you can download in a flash. Most of the time, you're stuck recording in real time. Another peeve: The standard lithium-ion cell lasted only about three hours, and a spare costs $60.

The other devices I looked at are part of a wave of products that should hit retail outlets in mid-August using Microsoft's Portable Media Center (PMC) software. Creative's Zen Portable Media Center and Samsung's YEPP YH-999, both $499, expose the shortcomings of this idea. The biggest negative is the limited recording capability. Unlike Archos', these machir accept only downloads of content that y have already recorded on your PC, encoded in Windows Media format.

The idea, of course, is to get more peo to use Microsoft's multimedia software i the home. For the small minority who ov Media Center PCs—and have survived th time-consuming process of getting and installing the necessary cables tie their PCs to TV, cable, or satellite feeds—transferring da from the PC to a portable medi center is easy. For everyone els budget a good number of hour to finding legally available movies and TV shows on the N There aren't many. And any content you do find will likely need to be transcoded into Windows Media format, whicl can literally take days dependi on the file size. Only then can y download that content to the portable player.

> For Archos' AV400, like its rivals, you'll need sharp eyes or strong glasses

The media-center approach does have its merits. One cool feature: With the upcoming Windows Media 10 software, for the first time, you'll be able to download son from subscription services such as Roxio's Napster to the portable players. (In the past you could download songs t your PC but not transfer them to players.) But lots of audi players, including the Archos, will support this feature, tc It seems the iPod's rivals will have to stalk this wily wabb for a few more years. ■

BusinessWeek online Stephen H. Wildstrom is on vacation. For a collection of past columns and online-only reviews, go to Technolo & You at www.businessweek.com/technology/

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BY LAURA D'ANDREA TYSON

Kerry's Health Plan: Coverage for (Almost) Al

According to a recent survey, more Americans worry about being able to afford health care than about losing a job or suffering from a terrorist attack. Their anxiety is justified. In the last three years, the cost of family health insurance has skyrocketed by over 40%, and 4 million Americans have joined the ranks of the uninsured. Eight out of 10 of the uninsured are members of working families. And having insurance does matter to one's health. The uninsured receive less preventive care, are diagnosed at more advanced stages of disease, and once diagnosed, receive less care and suffer higher mortality rates than the insured.

President George W. Bush and Senator John Kerry have different visions about what the government should do to tackle this crisis. According to independent estimates by Emory University health economist Kenneth E. Thorpe, the Bush plan of limited tax credits for the purchase of health insurance would cost about $90 billion over 10 years, providing coverage to about 2.5 million more Americans. The Kerry plan would insure 27 million additional Americans, resulting in coverage for 95% of the nation's citizens and 99% of its children at a 10-year net cost of about $650 billion. Kerry would pay for his health plan by rescinding the Bush tax cuts for those with incomes in excess of $200,000 a year, restoring their tax rates to the levels that prevailed under President Bill Clinton. Lest we forget, the '90s were years of rising budget surpluses, falling interest rates, high productivity and economic growth, and record low unemployment.

THE STRENGTH OF KERRY'S health proposals is that they build on America's existing health-insurance arrangements. One plan would expand funding for Medicaid and the State Children's Health Insurance Program, which already cover millions of people. This would extend coverage to more working families who currently earn too much to qualify for these programs but too little to pay for health insurance on their own. Kerry is also proposing refundable tax credits for the purchase of health insurance by small businesses, workers between jobs, and people from the ages of 55 to 64 who do not have employer-based coverage. Finally, individuals and businesses would also be able to buy coverage in a national group-insurance scheme modeled on the Federal Employees Health Benefits Program, which currently covers more than a million federal workers.

Perhaps the most important component of Kerry's health plan is the creation of a government reinsurance program to cover a significant share of the costs of catastrophic claims, reducing their burden on private insurers and businesses that provide insurance for their employees. Less than one-half c 1% of all insurance claims are responsible for 20% of healt insurance payouts. Insurers have huge financial incentives avoid such claims by denying coverage to the seriously ill a those in danger of becoming so. As a result, those most in need of insurance are least likely to be able to get it. And th who can buy insurance are forced to pay higher rates that reflect not only the likelihood of their own catastrophic cost but also the cost of others, including the uninsured.

Kerry's reinsurance program would reimburse employer and other group health-insurance plans for a substantial portion of the costs associated with such claims. To be eligi for government reinsurance, businesses would have to offe affordable coverage to all of thei workers. Health economists estimate that Kerry's reinsurance program would cut health-insurance premiums by as much $1,000 per year and make them more stable over time.

> Insurance premiums would fall by as much as $1,000 a year

Critics of the Kerry plan claim will simply redistribute income from wealthy Americans to the uninsured. Not so. It will make t insurance market more efficient, reduce premiums for everyone w purchases insurance, and provid all Americans access to the same choice of private health plans enjoyed by those who work for the federal governmer including members of Congress.

As insurance premiums soar, as large numbers of workers bear the personal cost of job loss, and as an even larger numb worry about losing their jobs sometime in the future, health insurance has emerged as a potent issue that could tip the ba ance in this year's Presidential election. On this critical issue, the candidates offer voters a clear choice. A comparison of th plans demonstrates that one is clearly superior to the other.

Laura D'Andrea Tyson, *dean of London Business School, chai the Council of Economic Advisers from 1993 to 1995 and is an informal adviser to Democratic Presidential nominee John Ker*

AMES C. COOPER & KATHLEEN MADIGAN

Corporate America Picks Up the Baton

siness investment is stepping up as consumer spending slows

U.S. ECONOMY The Commerce Dept.'s report on second-quarter l gross domestic product contained one glaring number: nsumer spending grew at a paltry annual rate of 1%. Not in three urs—during the last recession—have households posted such a ak performance. As a result, worries about the economy in the

nd half would seem natural. After all, consumer ding makes up 70% of GDP, and households have the economy's growth leader in recent years. t this business cycle has reached a milestone that ld ease some concerns about the second half. The nd-quarter GDP report was a clear sign that umers no longer have to run as hard as they have in ast for the economy to keep moving forward at a hy pace. Indeed, businesses, spurred on by the ing conviction that the recovery is now on solid nd, are taking the baton from households.

e more interesting feature of last quarter's GDP rt was that the economy still managed to grow 3% ite the sharp consumer slowdown. Indeed, consumer ding contributed only 0.7 percentage point of the ter's overall growth rate. Growth of 3% in one ter is a good showing by any standard, even pared with the high-productivity period of the past de, when real GDP growth averaged 3.3%.

ook at the data. Last quarter, business spending on pment grew at a 10% annual rate. Construction ys for new offices and warehouses rose 5.1%, inuing a turnaround from one of the worst collapses ecord. Exports soared 13.2%. Plus, businesses are ng to their inventories at a faster rate than they did year, with plenty of room for further growth. With like that, consumer spending doesn't have to grow % per quarter, as it averaged during the year prior to quarter, for the economy to perform well.

E OF THE BEST SIGNS of the business sector's mentum is the continuing high level of activity, ecially in the U.S. industrial sector. The Institute for ply Management's index of manufacturing activity—a posite of orders, production, employment, ntories, and delivery times—rose to 62% in July, from % in June. A reading above 50% shows that business rowing. The gauge has been above 60% for nine nths in a row, hovering at levels not seen since the m in the early 1980s. The ISM also reported a big p in nonmanufacturing activity in July.

n fact, according to the ISM, the recent level of its ustrial index is usually associated with much faster economic growth. The ISM says that, based on past relationships, the 62.2% average for the index so far this year has typically corresponded to 7.1% growth in real GDP. The unflagging strength in the ISM's indicator in recent months suggests two things: One, that businesses do not see any fundamental downshift in consumer demand. And two, that overall growth will most likely speed up again in the second half.

A HIGH LEVEL OF INDUSTRIAL ACTIVITY

Data: Institute for Supply Management, Global Insight Inc.

A growing backlog of unfilled orders and skimpy levels of inventories are two key reasons. Commerce Dept. data show that in June the order backlog for manufacturers, excluding big aircraft orders, grew 14.1% from the year before, a pace that exceeds the peak growth rate during the late-'90s boom. That means plenty of second-half production is already in the pipeline.

Moreover, the ISM noted that respondents to its July survey said that "their customers do not have sufficient inventories on hand at this time." The GDP report showed that businesses increased their inventories by $47.5 billion, after boosting them by $40 billion in the first quarter. That's a faster rate of accumulation than last year, but at the current rate of growth in demand, a much faster pace is needed to keep up. That will be another source of new production in coming months.

NO WONDER BUSINESSES continue to invest heavily in new equipment, especially high-tech gear and software, which increased at a 13.8% annual rate last quarter. Outlays for software grew more slowly last quarter, but purchases of new computers accelerated. And even given a dropoff in auto demand, overall business outlays for transportation equipment grew at a 10.1% rate.

One of the most encouraging signs for capital spending is that outlays for new construction are finally turning the corner. Such spending had plunged 28% from late 2000 to

early 2003, but it has risen in three of the past five quarters and is no longer a drag on overall business investment.

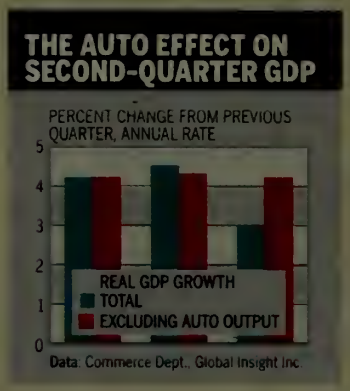
A gusher of cash flow is giving businesses the wherewithal to increase their capital outlays. *BusinessWeek*'s tally of 900 companies shows a 41% gain in net income from continuing operations, excluding extraordinary items (page 80). Profits will not maintain that rapid yearly rate in coming quarters, but cash flow will nonetheless remain sufficiently plentiful to support a strong pace of capital spending.

SO WHY DID CONSUMER SPENDING swoon last quarter—and is it something to worry about? The popular explanation is that outlays for costlier energy, mainly gasoline, displaced a lot of spending on discretionary items, such as cars or appliances. Clearly, that was a factor, given the 27% annual rate of increase in consumer energy prices in the first half.

But unless oil skyrockets to $50 or more per barrel, creating a whole new drain on purchasing power, most of the damage from $40 oil has already been done. True, hourly wages have slowed, but because more workers are now earning a wage, personal income growth has accelerated, rising at a 6.5% annual rate last quarter. At that pace, households will be able to recoup their lost buying power this quarter. And if oil prices come down, that would be an added boost.

Other factors, however, were at work on consumer spending last quarter, including some unusual quarterly gyrations. Spending on basic necessities, including food and clothing, were oddly weak last quarter, after unusually large gains in the first quarter. The true tre somewhere in between, and the quarter's weakness in this key category will almost surely be reversed.

The softness in autos, where costlier energy may ha postponed some car buying, makes more sense. Yet tha weakness won't be repeated either. Sales cars and trucks fell at 11.5% annual rate last quarter, and motor ve output plunged 25.5% itself, auto output cut percentage points fro GDP. Minus autos, real GDP would have grow 4.2% (chart).



But with a new ro of sales incentives in place, car buying is rebounding. Auto companies reported that July sales jumped to a 17.3 million annual rate, up from June's 15 million pace. Moreover, second-half production sched suggest that last quarter's dropoff in output won't be repeated this quarter.

Clearly, last quarter's 1% growth in consumer spend doesn't reflect the true trend. More important, even if consumers decide to ease back a bit from their spendin spree of the past year, the economy has plenty of suppo from other sources to help keep it chugging along. ■

FRANCE

Consumers to the Rescue

FRANCE'S CONSUMERS put the country near the top of the euro zone's growth table last quarter. But businesses seem wary of adding to their payrolls, despite growing demand. It stands to reason that both trends can't co-exist for very long.

In June, the ranks of the unemployed grew by 7,000, pushing the jobless rate to 9.9%. What's more, the employment index remains below the 50% level, indicating a decline in hiring. But the July factory purchasing managers' index showed scant signs of a reversal. The survey of manufacturers showed demand is healthy, and the level of unfilled orders is on the rise. Clearly, businesses are striving to meet demand by lifting productivity instead of adding workers.

Nevertheless, consumers are spending. Outlays for manufactured goods in June jumped 8.5% from the previous year, aided by seasonal summer discounts. But spending is also getting a lift from non-labor-market forces.

Eric Chaney, an economist at Morgan Stanley, points to several factors. Unlike in Germany and Italy, France's housing market has taken off. June housing starts were up 10.2% from the year before, and home prices are rising. Consumers are taking advantage of low interest rates. Indeed, the European Central Bank's rate of 2% is below France's 2.7% inflation rate. The upshot is more spending on household good which in June climbed 23% from th previous year. Chaney also believes slowdown in spending in response price hikes associated with the 200 rollout of the euro has ended.

In order to fund the uptick in spending, households are dipping into savings. That may not be a problem. As Chaney notes, the personal savings rate in France is 1 of aftertax income, leaving some allowance to draw down savings.

Finally, the economist argues tha progress in pension and health-car reforms may be a positive factor. H notes that while the reforms are painful, they help shore up the syst and, thus, long-term income expectations. All this means France consumers may have the will and t way to keep spending until the labo market turns around. ■

–By James Mehring in New Y

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THE WAR ON TERROR

WHAT COMPANIES NEED TO DO

While financial firms have increased security greatly, many others have not. But more safety doesn't have to cost a bundle

MONDAY, AUG. 2, WAS anything but an ordinary workday—at least in New York and Washington. Police officers carrying semi-automatic rifles rode the capital's Metro subway trains. Commercial trucks were barred from entering Lower Manhattan through the Holland Tunnel. Harried workers in key financial centers—the New York Stock Exchange, Citigroup's midtown headquarters, and the World Bank-International Monetary Fund complex in Washington's Foggy Bottom—endured long lines for ID checks, police dogs sniffing their briefcases, and intense screening on their way to work.

But elsewhere in America, screaming headlines about al Qaeda's plans to attack financial targets hardly ruffled the doldrums of deep summer. The nation's tallest building, Chicago's 110-story Sears Tower, didn't add to its 100 security guards. In Cincinnati, Procter & Gamble Co. said it was content with its current level of security at home and abroad. Disneyland and Warner Brothers Inc. in Southern California added no new security above the enhanced levels that followed the September 11 attacks. The message was the same at Boeing Co.'s sprawling Seattle aircraft plants. Only in San Francisco was added police activity visible. Computer files captured from al Qaeda operatives in Pakistan mentioned the city's 52-story Bank of America Center—which also houses Goldman, Sachs & Co. and Morgan Stanley branches.

Three years after September 11, U.S. companies have widely divergent approaches to security—ranging from la intense—based on whether their ind tries are considered vulnerable a where they are located. Companies he quartered in Washington and New Y cities already hit by al Qaeda, are spe ing freely on security and redundant c trol and communications systems.

But even as Homeland Security Sec tary Tom Ridge warns of heightened r of a preelection terror attack, busines in other major cities are taking more cost-benefit approach—and deciding t the safeguards they've added since S tember 11 will meet the risks they're li ly to face. Nearly 40% of the top exe tives of 96 midsize companies recen surveyed by the Conference Board agr that "security is an expense that ough be minimized." The Conference Bo study found that 45% of the compar

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E THE NYSE
fficers with
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Street after
. 2 alert

reported spending no more on security than before September 11. Some "keep betting that it's not going to happen" to them, says former New York Mayor Rudolph W. Giuliani, who now runs a private security consulting firm. "You have to have your head in the sand not to be doing anything about [terror] if you are responsible for large numbers of people."

Still, it makes sense for the obvious targets to do the most to boost the security of their buildings and employees. That explains why the financial industry has taken the lead. Building on the hard-won lessons of the 2003 blackout, Hurricane Isabel, Y2K upgrades, and the four-day shutdown of the NYSE after September 11—the industry has invested heavily in redundant networks and emergency plans. As a result, the odds that markets and money flows will function if another attack occurs are much improved.

Unfortunately, that has turned Wall Street into something of a bunker these days. Investment banks, some of which were forced to abandon their headquarters after September 11, are spending as much as three to four times more on security than they did before the attack. "The financial-services industry is simply smarter than the federal government about this," says Larry C. Johnson, a former CIA counterterrorism expert and CEO of risk-management firm BERG Associates LLC.

Today, the NYSE has an upgraded backup facility—in an undisclosed location—that could take over trading within hours of an attack near the corner of Wall and Broad Streets. Vows CEO John A. Thain: "We will not be intimidated by terrorists." Similarly, the Federal Reserve Bank of New York, which responds to crises such as 1987's Black Monday by flooding markets with liquidity, can quickly shift its open-market operations to satellite offices in East Rutherford, N.J., or one of the 11 other regional Fed banks.

"LESS VISIBLE MEASURES"

AT CITIGROUP, WHOSE headquarters was targeted by al Qaeda, the bank is on high alert through the coming Aug. 30-Sept. 2 Republican National Convention. Visitors can expect heightened ID checks and baggage screenings along with "certain less visible measures" that the company won't detail. Granted, none of this guarantees that another massive assault wouldn't disrupt markets. But experts say the truck-bomb attacks detailed in the latest al Qaeda intercepts would not shut down either Wall Street or the economy.

In Washington and New York, the latest terror alert had security consultants hopping. "Our phones are ringing off the hook," says Howard Safir, a former New York City police commissioner and now a partner in Safir Rosetti, Inc. a New York security consulting firm. He says the specificity of the terror alert "really got people's attention. A lot of [companies] that were hesitant to move forward want to do it now."

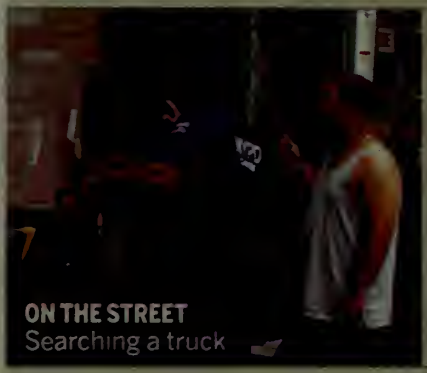
He and others say they're typically called in to evaluate physical security and advise companies on what's missing. The next step—only lately being undertaken by companies outside the high-risk zones—is to add such enhancements as off-site emergency offices and data storage to their capital budgets. James Lee Witt, the Clinton Administration's disaster chief and now a private consultant, recently drew up such p for clients ranging from the Universi Southern California to Nextel, in a tion to reviewing emergency plans Entergy's Indian Point nuclear p near New York City.

For companies outside major ur areas that feel they have already ta sufficient precautions, cost is a big is With the recession still fresh in ex minds, many remain unwilling to sp on anything that won't generate pr In the absence of official security m dates, many "are reluctant to spend m ey if their competitors aren't doing same because they fear it could put t at a cost disadvantage," says Ran Larsen, CEO of Alexandria (Va.) cons ant Homeland Security Associates.

Yet not all the solutions are costly.

How Safe?

New terrorist threats are forcing U.S. companies to take a hard l security. What's needed—and what's lacking:



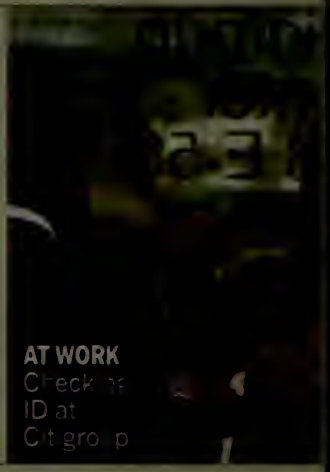
ON THE STREET Searching a truck

PREVENTING VEHICLE BOME

- **ERECT CURBSIDE BARRIERS** to block cars from penetrating a lobby. They're common ar government buildings but missing elsewhere
- **TIGHTEN GARAGE SECURITY** with stepped inspections. Most commercial garages just w parkers in and out.
- **STAGGER DELIVERIES** and schedule for off reduce daytime truck traffic. Rare outside of

IMPROVING ON-SITE SECURITY

- **STEP UP ID CHECKS** and visitor controls. Guards at many buildings are about as effective as pre-September 11 airport screeners.
- **SECURE VENTILATION SYSTEMS** from biohazard attacks. Rare outside of government facilities.
- **BOLSTER VIDEO MONITORING** with threat-recognition software to back up human surveillance. Rail yards and other remote sites are only now deploying such systems.
- **INSTALL BLAST-RESISTANT GLASS** to reduce casualties. Sales of films to coat windows are soaring.



AT WORK Check ID at Citigroup

OFF-SITE Secure document storage

ENSURING CONTINUITY

- **BACK UP RECORDS** in a remote location an redundant communications systems.
- **BUILD REMOTE OPERATIONS** centers where employees can keep high-risk businesses run Often found in financial services but less com other industries.

ity cameras outfitted with software to ognize unusual situations or move- nts can replace guards. Blastproofing ndows with special films could avert uries from explosions. Planning in ance for off-site workspace or com- nications in the event of an emer- ncy can get a company up and run- g quickly after an attack. And smart npanies give their workers an 800 nber to call in emergencies.

ICK WALLS, LOW PROFILE

ONG WITH UPGRADING security neras, bolstering ID checks, and im- ving other on-site protections, secu- experts argue that more companies, ticularly outside the Washington-to- ston corridor, need to strengthen at's known as "business continuity nning." Unmarked buildings such as data center in an unremarkable of- park near Dulles International Air- t serve as insurance against both ter- ist assault and natural disasters. The lity was built to house Web and data- e servers and communications gear financial institutions and others. Its ndows are fake and the exterior walls constructed with a sandwich of st-proof Kevlar between two layers of crete block. Power comes from two arate mains, with a diesel generator blackouts. Access is through double ors by a biometric handprint reader.

The good news, experts say, is that siness is starting to look to leading in- stries, such as financial services, as a del. Business Executives for Nation- Security, a Washington-based group CEO volunteers, is spearheading an ort in New Jersey to create a database rucks, food, and medicine that could used in an emergency. The group is n pestering the federal government do a better job of backing up its own ancial data. Steve Chupa, security di- tor of a large company in New Jersey, n has some praise for Washington identifying buildings targeted by al eda. "It doesn't matter so much that information [the Homeland Securi- Dept.] is giving us is dated," he says. he lesson is, they are finally sharing." No doubt business remains on a ep learning curve. But the lessons of ptember 11 and its aftermath—plus ricanes, blackouts, and computer tches—are starting to spread. Is erica safe? Not yet—and it has a long y to go. ■

–By Paul Magnusson, with Emily Thornton, Diane Brady, and Spencer Ante in New York, with bureau reports

ELECTION 2004

DOING THE SWING-STATE SHUFFLE

Bush and Kerry tailor their appeals to the economies of states they're wooing

WEST VIRGINIA Will recent job losses dim Bush's appeal?

FROM ITS START, THE U.S. economic recovery has been unusual. Even now, three years into the upturn, growth is strangely uneven. Some states are booming. Others remain mired in the slowdown.

With things somewhere between "Morning in America" and recessionary malaise, both Presidential candidates are struggling to come up with a coherent message that will play in vital battleground states with widely divergent outlooks. The President had hoped to run for reelection on a robust recovery, but the continuing struggles faced by industrial states make his paeans to a strong economy ring hollow to many swing voters. At the same time, the national rebound has forced Kerry to change his downbeat rhetoric as he tries to woo voters in key states such as Florida and Arizona that are prospering.

As a result, both candidates are resorting to some fancy footwork. Bush is reminding anxious voters of the post-September 11 shocks the economy has endured, stressing his empathy for suffering workers, and charging that Big Government Democrats would stifle growth. Kerry, meanwhile, is playing down talk about "the worst economy since Herbert Hoover" and emphasizing a middle class squeezed by rising costs for health care, gasoline, and tuition.

For Bush, the manufacturing meltdown in Michigan, Ohio, and Pennsylvania puts him at risk of losing three big battlegrounds, totaling 58 electoral votes. In Michigan, Steven Jakubiak, a mailman in Battle Creek, says the President has not concentrated enough on the economy and has spent too much time on Iraq. "I understand the safety of our country, but that's not the only issue," says Jakubiak, 50. "Jobs and manufacturing are just as important." Bush

seems to have heard that message during a recent visit to Ohio. The state has lost 232,000 jobs—a 4.1% drop—since he took office. "The economy is strong, and it's getting stronger," Bush asserted in a July 31 event at the Canton Memorial Civic Center. But he added: "It lags in places like eastern Ohio, I know that. I'm aware of that."

Less clear-cut are the 8 swing states with 79 electoral votes that, while improving, aren't close to regaining the jobs they have lost in the Bush era. Among them are three states the President carried in 2000: Arkansas, New Hampshire, North Carolina, and West Virginia. Democrats are hoping that the loss of North Carolina jobs—payrolls have dropped during the Bush years by 94,100, or 2.4%—could move Vice-Presidential candidate John Edwards' state into their column. "I've seen a lot of companies move their help desk to India," grumbles Chris Terrell, 33, a telecom sales representative in Greensboro. A lifelong Republican, Terrell says Kerry "could steal me away."

On the flip side, the booming economies of Republican-leaning Arizona, Florida, and Nevada are likely to help the President hold on to the three states—with 42 electoral votes. Arizona has added 75,000 jobs since January, 2001, while Florida has added 286,000, for increases of 3.3% and 4.0% respectively. And Nevada created 75,000 jobs in the same period, for a 7.7% gain.

Not surprisingly, voters in such states are upbeat. "Arizona is the boom center," says Cathy Weir, 39, a bank branch manager at Fidelity National Title Insurance Co. in Scottsdale. "The low mortgage rates have kept me smokin' busy." Adds Dan Stark, 50, a marketing director for Boyd Gaming Corp. in Las Vegas: "Bush figured out how to grow the economy, and the deficit is starting to shrink." Meanwhile, robust growth in New Mexico—the only state that avoided slipping into recession—gives Republicans hope of capturing a prize they lost by just 366 votes in 2000.

Republicans are also optimistic about swing states where the recovery has been strong, including Minnesota and Wisconsin. Al Gore narrowly carried both four years ago, but Bush is targeting them now. Says Andy Laperriere, a managing director at institutional broker ISI Group Inc.: "It's a real challenge to convince people that the economy is bad when they see 'Help Wanted' signs all over."

Still, for every bit of good economic news there are warning signs, too. In a July 30 report, the Labor Dept. says that only about two-thirds of long-term workers who lost their jobs during the first three years of Bush's Presidency have found new work. And of those who have found positions, more than half of the new jobs pay less than their old salaries.

To downplay such negative trends, GOP strategists are stressing social issues such as abortion, gay rights, and the death penalty in an effort to win the votes of financially stressed but culturally conservative Catholic swing voters. And with the President holding a wide lead among voters who are most concerned about terrorism, his campaign is taking every opportunity to emphasize Bush's role as Commander-in-Ch The danger: By gliding over lunch- economic concerns, he risks coming as out of touch with the daily strug of working families.

How the Swing States Are Faring

How big a factor will the economy be for voters in the key swing states? Here's how they shape up:

States won by George W. Bush in 2000
States won by Al Gore in 2000
(Percentage change in number of jobs since January 2001)

N. CAROLINA PLANT Shut

STILL STRUGGLING
With big job losses and little recent gain, the economy will be a liability for Bush in these states

Michigan (-4.6%)
Ohio (-4.1%)

FEELING SOME PAIN
Jobs are beginning to return in many areas, but Bush could pay a price as conditions remain worse than four years ago.

Iowa (-2.1%)
Oregon (-1.1%)
Pennsylvania (-1.3%)
Colorado (-3.5%)
New Hampshire (-1.5%)
North Carolina (-2.4%)
Tennessee (-1.2%)
West Virginia (-1.0%)

ON THE MEND
The rebounding economy could help the President here

Maine (No change)
Minnesota (-0.6%)
Washington (-0.5%)
Wisconsin (-0.1%)
Arkansas (-0.7%)
Louisiana (-0.5%)
Missouri (+0.2%)

DOING FINE
Healthy job growth will boost Bush. Kerry needs other issues to win in these states.

New Mexico (+4.9%)
Arizona (+3.3%)
Florida (+4.0%)
Nevada (+7.7%)

Data: Labor Dept.

MIDDLE-CLASS SQUEEZE

KERRY'S STRATEGISTS think they h found a message that will play in st with good economies and bad. "Ther an economic argument that works ev where—and that is that middle-c voters feel increasingly squeezed prices that are rising incomes that are st nant," says Kerry ca paign pollster M Mellman. "Whet you're talking ab Ohio or Nevada and A zona, health-care co are skyrocketing."

That resonates w voters like Sienna W niemko, a buyer's as tant at Sharon Luggag Gifts in Charlotte, N "We have all felt squeeze because health-insurance pre ums have gone up, a for the most part benefits have not," s Wyniemko, a Bush vo in 2000 who is unde ed now. "The result been there haven't b any pay increases three years."

Still, the Democr acknowledge that t tailor their econo message to fit local e nomic realities. Th says senior Kerry stra gist Tad Devine, me emphasizing job los in Ohio and sluggish salary gains in Fl da. The strategy comes with a r though: The litany of woes leaves Ke open to charges that he's too pessimi about the rebounding economy.

If solid economic growth means Ke can't carry Arizona, Florida, or Neva can he still win the election? The ans is yes—if Ohio's job losses tip that la must-win Bush state to the Democr So, the economy could certainly make difference this year. The only questior which economy? ■

–By Richard S. Dunham a Rich Miller in Washington, with A Therese Palmer and Michael Arnd Chicago, and bureau rep

THE POLLS

Behind the Numbers: A Hidden Bounce for Kerry

First came the seamless convention, a Democratic pageant unblemished by doubt or discord. Now pundits are puzzling over a new phenomenon—the bounceless convention.

In what looks like an anomaly, Democrat John Kerry, who delivered a well-received acceptance speech at his party conclave in Boston, seems to have reaped little gain. While post-convention jumps in opinion polls typically range from 10% to 15%, new surveys show the Massachusetts senator left Boston gaining at most 5% against President George W. Bush. One, the CNN/*USA Today*/Gallup poll, even shows Bush pulling ahead 50% to 47%, leading critics to argue that Kerry missed his big chance to convince folks that he's got the right stuff.

EDGE Kerry leads the Electoral College, a new poll says

But such interpretations miss the significance of an electorate where most voters have made up their minds. With just 17% still undecided, according to a July 30-Aug. 1 ABC News/*Washington Post* poll, tectonic shifts aren't likely. "There's a lot of ice in the river, and it's hard to get much movement," says ABC polling director Gary Langer. That means when the President decamps from New York City on Sept. 2 after the GOP convention, he may not move the dial much, either.

A better way to assess Kerry's performance is to look past the horse-race numbers and dig down into the public's answers. By that standard, he helped himself. In an ABC/*Washington Post* post-convention poll released on Aug. 2, Kerry holds a 49% to 47% edge among likely voters, a 6-point swing from a month earlier. The Democratic candidate fared much better on personal qualities, where he had suffered in comparison with Bush. On the crucial question of leadership, Kerry cut Bush's pre-convention lead of 19 points to just 6. On the question of which man would keep America more secure, he sliced a 16-point Bush margin to only 3.

How about "values," a word that kept ricocheting inside the FleetCenter? While Bush had a 6-point advantage before the Democratic gathering, Kerry now leads the President by 6. "The convention allowed voters to deepen their understanding of John Kerry's background, values, and plans for the nation," contends campaign pollster Mark Mellman. "From that point of view, it was completely successful."

Bush aides, of course, beg to differ. Senior strategist Matthew Dowd crows that Kerry received "the worst lift in the polls since [Democrat George] McGovern in '72," which was the biggest debacle in modern electoral politics. Indeed, polls show that Republicans reacted to the Democratic pageant in Boston by becoming even more ardent in their support for Bush—an intensity factor that could play out in higher voter turnout.

Still, Republican strategists have a much harder time explaining why swing voters are more smitten than ever with Kerry. And while national polls appear little changed by the convention, the extravaganza may have solidified the Democrat's edge in the only count that matters: the state-by-state battle for the Electoral College. According to a Zogby International poll released on Aug. 3, Kerry holds a clear electoral vote lead over Bush, 291 to 215. That's 21 more votes than needed to win, with some 32 electoral votes left in states too close to call.

Of course, the tally is likely to change if the Republicans manage their convention as successfully as the Democrats ran theirs. And swing voters—who are impressed with Kerry but not yet sold on him—could easily shift back and forth a few more times before the election on Nov. 2.

In an era of ultrapolarized politics, the 30-point bounce received by victorious challenger Bill Clinton in 1992 or the 15-point spurt enjoyed by eventual loser Bob Dole in '96 is unlikely to be repeated. But that's not to say that a mini-bump should be dismissed out of hand. These days, a Presidential candidate should be grateful for any bounce that he can get.

–By Lee Walczak and Richard S. Dunham in Washington

A Bump Up—But Will It Last?

On key issues, the Dems' convention improved Kerry's standing with voters

WHICH CANDIDATE DO YOU TRUST TO HANDLE...	PRE-CONVENTION		POST-CONVENTION		WHICH ATTRIBUTE APPLIES BETTER TO THE CANDIDATE?	PRE-CONVENTION		POST-CONVENTION	
	BUSH	KERRY	BUSH	KERRY		BUSH	KERRY	BUSH	KERRY
The Economy	47%	46%	41%	52%	Leadership	55%	36%	50%	44%
Taxes	49	43	43	49	Security	54	38	48	45
Terrorism	55	37	48	45	Values	49	43	44	50
Iraq	52	40	46	47	Honesty	46	40	41	47
Health Care	44	47	36	55	Consistency	64	24	60	31

Data: ABC News/Washington Post polls 7/22-25 (909 registered voters) 7/30-8/1 (940 registered voters). Margin of error + – 3 percentage points

CHIPMAKERS

'THIS IS NOT THE INTEL WE ALL KNOW'

The giant has fallen behind in chips for multimedia—and investors aren't happy

FOR YEARS, INTEL CORP.'S aggressive chip-delivery schedule has been as predictable as, well, Moore's Law. The chipmaker consistently doubled the number of transistors on a processor every two years, just as the man said.

Lately, though, Intel's road map—the delivery schedule it uses to let customers know when new products will hit the market—has taken as many twists as an Alpine pass. Over the past eight months, Intel has suffered a string of delays and manufacturing snafus. The latest occurred on July 29, when it said a speedy new 4-gigahertz Pentium chip due by yearend would be delayed until 2005. It's enough to make investors grouchy—and put CEO Craig R. Barrett on edge. "This is not the Intel we all know," he e-mailed employees, "and that is not acceptable."

Why is Intel overpromising and underdelivering? The problems stem from mistakes made five years ago in the design of its Pentium chip. Execs misjudged, believing PC makers and consumers would continue to embrace ever faster, power-hungry chips. Now the latest iterations are ill-suited to today's corporate desktops, as well as the new multimedia home PCs that are the focus of a major Intel push this year. Intel says the problems are only temporary. "We continue to expect to exit the year with the vast majority of our desktop and notebook processors on the [new] technology," says spokesman Robert Manetta.

Still, Barrett and President Paul S. Otellini, who runs day-to-day operations, are playing catch-up. That has led to manufacturing glitches as overworked engineers scramble to design chips that will support everything from better sound and personal video recording to shuffling multiple video streams around the house. Manetta acknowledged the schedule may have been too aggressive.

HIGH STAKES Pentium 4 production

Why the Chips Are Down

- The semiconductor giant is struggling to break into products that will support the digital home and hurrying to produce a variety of chips suited to multimedia applications
- The company's Pentium chip tends to overheat and draw too much power for the current demands of the desktop PC market
- In a rush to come out with new products, Intel's engineers took on too many projects at once, which led to manufacturing snags and design glitches

Intel's plan faces delays because the current Pentium desktop chip design is outdated—and, in fact, poorly suited for consumer electronics. One big problem, say PC makers: The latest version of the Pentium 4 draws too much power and therefore produces too much heat. Ur can fix the heat problem, PC makers install the chips in their machines.

Those challenges have been pounded as Intel adopts new manufac ing technologies. The shift has allowe company to churn out huge numbe chips—but not the high-end ones makers had been promised. As a result tel has racked up big inventory gain Dell Inc., Hewlett-Packard Co., and ot slowed purchases of older chips in ar pation of the new ones that have yet t rive. PC makers are loath to criticize t main supplier, but a spokesman for leading manufacturer says Intel's bl deadlines have "royally delayed thi Computers we had planned for Noven now have been pushed to January."

A CASH PAYOFF?

INVESTORS AREN'T HAPPY with In performance, either. The stock is stuc about $24, well off its 52-week high of Some believe Intel is pushing too hard too fast into chips for digital home e tronics, a sector that the likes of Texas struments Inc. and Philips Semiconc tors know more about. Instead, t argue, Intel should stick with less exotic and server chips and expand overs Others are pressing Intel to hand b some of its precious $14 billion cash ho "I'd rather have [a] payoff than have I venture where they don't have compe cy," says Peter Hofstra, senior analyst AIC Ltd., which holds about 355,000 I shares. Intel CFO Andy D. Bryant has such an option is possible.

Others say Intel must press ahead the past six months, Advanced Micro vices Inc. has gained ground in consu PC chips, winning about 50% of desk PC sales, according to researcher Curr Analysis. AMD is making inroads into se er chips, too. "We've become a credi competitor to Intel," says AMD Cl Technical Officer Fred Weber. "We've b executing very well."

What can Intel do to solve the pr lems? Otellini has cancelled further ite tions of the Pentium 4 and told engine to rush a cooler-running PC chip, bu won't be available until late 2005. In meantime he hopes to offset AMD's ga by boosting share in other chips and co ponents that will go inside a range of tertainment devices, many of which ca run on a Pentium. The risk is that Ir could again miss the mark and alienate customers. But given the high stakes, it bet execs are willing to take. ■

–By Cliff Edwards in San Mateo, Ca with Olga Karif in Portland, O

COMMENTARY

Y MICHAEL FRANCE

What Cheney Should Have Known

eing CEO of Halliburton apparently didn't mean being privy to a key decision

LET'S GET THIS STRAIGHT. IN the second quarter of 1998, Halliburton Co. made a big change in the way it accounted for cost overruns at its massive lobal construction projects. As a result, it eceived a boost to its pretax income for e year of 46.1%, to $278.8 million—even ough its underlying business had not anged at all.

The accounting maneuver was le-l, but it's certainly the kind of major ws investors have a right to know. onetheless, somebody at the com-ny decided not to tell them about it. ot a word was breathed in Halliburn's securities filings, earnings reses, or analyst teleconferences for e next six quarters.

Who's accountable? According to e Securities & Exchange Commis-on, the buck stops with Halliburn's former controller and chief fi-ncial officer, who are being fined d sued, respectively, for their roles the debacle. But the one person hom the agency specifically exclud-from blame is the man who rved as CEO at the time: Vice-Pres-ent Dick Cheney. In a rare move for deral law enforcers, the SEC issued press release on Aug. 3 declaring at "the investigative record devel-ed by its staff" did not justify any rther charges.

NO BLAME The SEC gave Cheney a rare absolution

This resolution raises more ques-ns than it answers. The second ost important political executive in r country claims to be ignorant of one of the key business de-sions his company made during his tenure as CEO. It may ell be that an underling was willing to make such an impor-nt call without telling Cheney, but make no mistake: This type scenario would be very rare, even in pre-Sarbanes-Oxley Cor-rate America. "The thing executives care the most about is w they look in terms of the numbers," says University of Texas School of Law securities expert Henry T.C. Hu. "An accounting decision that is going to affect performance by nearly half is usually the type of thing the CFO would discuss with the head of the company."

Even if Cheney didn't know about the disclosure decision, he should have. CEOs are paid big bucks for a reason: to stay on top of the important events going on in their companies. When it comes to maneuvers that have such a critical—and obvious—impact on earnings, ignorance is no excuse.

While Cheney's lack of knowledge may well have kept him out of court, where proof of state of mind is critical, it should not spare him from the wrath of investors. Moreover, he would never get away with such a head-in-the-sand defense now that Sarbanes-Oxley is law. In fact, one of the main reasons the law was passed was to force CEOs to assume more responsibility for their companies' public statements.

Will the issue of what Cheney knew, and when he knew it, ever be resolved? So far as the feds are concerned, it already is. One source close to the case says that Cheney was not a hands-on operation manager. Instead, this source says, he was "more of a chairman than a CEO, flying around the world making nice to governments so that he could land these big contracts."

But because of the obvious political sensitivity surrounding Halliburton, the SEC's verdict probably won't be accepted by many—at least until the underlying records in the case are released. Indeed, that's just what former Assistant Secretary of Defense John White, an informal adviser to the Kerry-Edwards campaign, was calling for on Aug. 4. "There are a lot of questions here that simply aren't being answered," he said in a press conference. "Why the secrecy?"

It will be a long time before the facts behind this case emerge, if ever. But it's hard to imagine any way in which Cheney will come out looking good. Even if the decision to hide the company's accounting change was made below his grade level, the Vice-President is likely go down in corporate history as yet another know-nothing CEO of the late 1990s—hardly a distinguished group. ■

–With Stephanie Forest Anderson in Dallas and Mike McNamee in Washington

BIG BETS A new Jeep Grand Cherokee is on the way; the Chrysler 300 is already a hit

AUTOS

CHRYSLER: A SMOOTHER RIDE, BUT BUMPS AHEAD

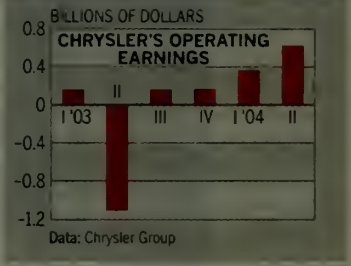
Can it keep turning out hot sellers—and keep Mitsubishi from dragging it down?

AS THE PAST YEAR HAS shown, declaring "mission accomplished" too soon can be a bad idea. Yet DaimlerChrysler Chief Financial Officer Manfred Gentz may have done just that on July 29 when he presented second-quarter results for its long-struggling Chrysler unit. Citing operating profits of $614 million, a sharp swing from the $1.1 billion loss a year earlier, Gentz proudly declared: "The turnaround plan has been completed."

Not so fast, Herr Gentz. While Chrysler has cut costs and nudged up market share thanks to such hit models as its stylish new 300 sedan, the company still faces plenty of challenges. Not all of the new models are wowing drivers like the 300. DaimlerChrysler's broken alliance with Mitsubishi Motors Corp. could imperil future models and its cost-cutting program. And once again, incentives are inching up, putting pressure on profits. All of which may explain why Chrysler Group CEO Dieter Zetsche was far more circumspect than Gentz. "We can't claim victory after a few months of very satisfying demand," he told the analysts.

There's little doubt that Chrysler's performance is much improved. Unlike Ford Motor Co. and General Motors Corp., it makes most of its money selling cars and trucks these days, while its rivals rely mostly on their financing arms for profits. Chrysler has managed this feat by slashing annual capital outlays from $7 billion to $5 billion and by selling a lot of cars with fat margins. Fully half of Dodge Rams, 300s, and Magnums sold feature the powerful new Hemi engine, released last year. The engine boosts profits $1,000 to $3,000 per vehicle.

BACK IN THE RACE?



Still, a couple of good quarters don't a turnaround make. Popular models have a nasty tendency to fade fast. The retro PT Cruiser sold a heady 145,000 units in 2001 only to slump to a heavily rebated 107,000 last year; sales are flat this year despite a new convertible. "No longer can new vehicles go without incentives for a year or two," says Adam Collins, senior auto analyst at Commerzbank in London.

And it's not as if Chrysler can count on more hits like the 300. The Dodge Magnum looks like a station wagon on steroids, but Americans have shown scant love for wagons since Richard M. Nixon occupied the White House. A conservatively redesigned Jeep Grand Cherokee will arrive this fall. But it will face a crowded, rebate-heavy sport-utility segment. Already, other new models Zetsche had hoped would sell without hefty rebates need them to move. Only ni months after the launch of the featu packed Durango SUV, Chrysler has had slather it with $4,500 in incentives; t Dodge Caravan and Chrysler Town Country minivans that Chrysler spe $400 million redesigning require so $4,000, including dealer cash.

SCUTTLED SUV

LONGER TERM, CHRYSLER may al face trouble sustaining its turnarou because of the deteriorating condition partner Mitsubishi, which on Aug. 4 a nounced a fiscal fir quarter loss of $4 million on sales of billion. When Daiml Chrysler announc that it would cea shoring up the Japane carmaker in April, ma feared that it would st working on jointly d veloping models wi Chrysler. The Neo Stratus, and Sebrin based on the next Mitsubishi Lanc platform, will appear next year, as e pected. But a Mitsubishi minivan ar SUV based on the Dodge Caravan ar Durango have been scuttled, as have tw other concepts on Chrysler's wish li All of that, say insiders, means less lon term sharing of buying and engineerir costs, which will limit the savin Chrysler was banking on.

For now, Chrysler has more immedia problems: Even as it is once more pou ing on the incentives to clear dealer lots 2004 models, analysts are predicting fl U.S. auto sales next year. That one-tw punch could hurt Chrysler's profits agai The bottom line: Chrysler isn't the clun er it was when Zetsche took over fo years ago. That may be worth honking i horn about, just not too loudly. ■

–By David Kiley in New York, wi Gail Edmondson in Frankfu and David Welch in Detro

CHART BY ERIC HOFFMANN/BW

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RETAILING

BABY BOOMER, COME HOME

Gap hopes a new chain will bring back women who once bought its jeans

BUILDING A CLOTHING brand from scratch is always a challenge. But Chief Executive Paul S. Pressler is betting that Gap Inc. can do it again. More than a decade after it launched its hugely successful Old Navy stores, Gap's diversification plans are starting to jell. Pressler had made it clear that he was considering acquiring or creating a new chain to add to the retailer's three existing brands—Gap, Old Navy, and Banana Republic. At a June conference, he told analysts: "Gap Inc. at its best is a brand-builder." Now, *BusinessWeek* has learned, Pressler has settled on a plan to develop a moderately priced clothing chain aimed at women aged 35 to 50. Although Gap wouldn't comment, Pressler and Old Navy chief Jenny J. Ming have been interviewing outside executives to run the new chain as well as designers for the creative side, say people who have learned about Gap's hiring plans.

Launching a new brand into an increasingly crowded market won't be easy, but analysts say Pressler has little choice. Having shuttered stores, cut costs, and revamped merchandise and marketing, he's now focused on boosting growth. But Gap's existing chains are already in practically every market. What's more, Pressler can't take his nascent turnaround for granted: As it is, June sales fell 2%, ending a 20-month streak of monthly increases. Says Arnold Aronson, managing director at consultant Kurt Salmon Associates: "There'll have to be another leg added onto the business."

PRESSLER Lower June sales hurt his record

The San Francisco-based company has big hopes for its new retail concept. G aims to generate an additional $1 billi to $2 billion a year in sales. That g would represent between 6.3% a 12.6% of its $15.85 billion in 2003 sal Based on last year's average per-st sales of $4.82 million at Banana Repu lic—and assuming that the new stor will be about the same size and char similar prices—Gap would need to op between 200 and 400 new locations meet its target.

SALES POTENTIAL

THE NEW VENTURE would targ women older than the typical Gap sho per but not as hip or fashion-conscious the Banana customer. Stor would sell several categories of a parel, ranging from weekend we to office outfits, with each catego marketed under separate su brands.

With the new stores, Gap courting the younger half of t boomers. That's a crowd it does currently target head-on, and o with more sales potential th boomers, now aged 50 or old "As men and women age, th spend less money on apparel says Jeffrey P. Klinefelter, analy at Piper Jaffray & Cos. The ne store could also help recaptu some of the customers who us to shop at Gap but have gone els where seeking more grown-u and comfortable clothes. The k will be to avoid stealing sal from Gap's existing stores. Rath than more low-slung, snug-fittir pants, designers will have to serve u loose, flowing pants—perhaps even wi elastic waistbands.

It's far from certain if there's muc room for yet another apparel chain. An lysts say the popular Chico's FAS Inc. the most formidable competitor, with i fashionable-yet-forgiving styles. Chico plans to open 90 stores this year, bringir the total to 640. And classics-oriente Talbots Inc. will add 75 stores to its exis ing 975 outlets.

Nor is Gap the only newcomer. April, kids' clothier Gymboree Cor launched Janeville, aimed at women and older, and expects to operate 14 stor by yearend. And the young-adult fa Abercrombie & Fitch Co. will unveil brand for the 25-to-35 crowd this mont potentially treading on Gap's toes. Wi this kind of competition, Pressler can on hope he won't be elbowed aside. ■

–By Louise Lee in San Mateo, Cal

Gap's New Baby

The retailer hopes to generate up to $2 billion in annual sales with a new venture aimed at women aged 35-50. The challenges:

CROWDED MARKET A bevy of other retailers, including Chico's, Talbots, AnnTaylor, and J. Jill already target the same women

DESIGN HURDLE The creative team must design clothes that are practical and comfortable for the Boomer body

BRAND OVERLAP Clothes and marketing will have to be distinctive to avoid stealing sales from existing Gap and Banana Republic stores

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COMMENTARY

BY DEAN FOUST

Things Aren't Going Better at Coke

New CEO Isdell entered to good news. But suddenly he has his hands full

WHEN IT COMES TO TURNing around a troubled company, timing is often everything. And hopes were running high when E. Neville Isdell took the helm of beleaguered Coca-Cola Co. in early June. After six years of mostly disappointing profits, Coke had just recorded a surprising surge in first-quarter earnings. With a new guy in the driver's seat and some promising new products on the way, Coke's dark days looked like they might be winding down.

No such luck. Just two months into his new job, Isdell's honeymoon is over. He's facing a host of problems, from sluggish growth in once-lucrative international markets such as Germany and Mexico to tepid consumer reception of new products like the much-ballyhooed C2 cola. But what seems also to have spooked investors are reports of simmering tensions between Coke and its increasingly powerful independent bottlers. What it all comes down to is syrup—how much of the stuff the bottlers will buy, and what price they're willing to pay. For years, the bottlers were at the mercy of Coke headquarters, as the cola giant pushed through huge increases on the price it charged for the prized concentrate. Now, the bottlers, newly empowered through a string of acquisitions, are fighting back.

HALF EMPTY? Distributors are giving Coke fits

Nothing would be more unsettling than a showdown between Coke and its largest bottler, Coca-Cola Enterprises Inc. (CCE)—a mega-bottler that now controls about 80% of the U.S. market as well as parts of Europe. CCE's strategy has been to raise sharply the price it charges grocers and other retailers. That's boosting its profit margins—but at the expense of Coke. Higher retail prices mean consumers buy less of its soda, so bottlers don't need to buy as much syrup from headquarters. For the second quarter, Coke's volume sales rose a mere 1%, well below its 5% target. That's Coke's lowest quarterly increase in volume sales since the 1970s, says Emanuel Goldman, an independent beverage analyst in Hillsborough, Calif. And it helps explain why Coke's operat income, after subtracting currency gains, rose just 7% in the ond quarter, about half what some analysts expected.

Investors are fretting. Coke's shares have fallen more t 10% in the two weeks since the earnings news, leaving th near their low for the year. Says Nancy Crouse, a senior v president at Delaware Investments, a Philadelphia money m ager that holds 3 million Coke shares: "I don't have as m confidence as I did three or four months ago of their abilit drive the profitability of the business."

More price hikes from CCE and other bottlers are expect which could cut even further into concentrate sales. One rea for the continued hikes: the prospect of sharp increases in cost of key commodities like resin and aluminum. The li lihood of a further bump up price "will put CCE and Coke i direct conflict...at a time wl tension is already running high tween the two," notes Mor Stanley analyst William Pecorie

Officials from Coke have l maintained that relations w CCE are fine, though they decli to comment for this story. CCE, conference call with analysts, sured investors that they have issues with Coke. Still, the pr lems between Coke and some of bottlers could force Isdell to m some radical moves—including buying back some of its b tlers. That, of course, would be the ultimate irony. It was v back in 1986 that Coke spun off its domestic bottling operati into the entity now known as CCE.

That move was a cornerstone of then-Chairman Roberto Goizueta's efforts to turbocharge Coke's returns by remov billions in bottling debt from its balance sheet. Selling syru also a much more lucrative business than bottling. The m worked brilliantly for years, a Goizueta was hailed as a geni But, as they say, what g around comes around. Now, bottlers are all too willing to their muscle. Although Coke s owns 39% of CCE shares, that l fallen steadily over the yea With Coke no longer calling shots, Isdell is finding that the no quick or easy way to get fizz back into Coke. ■

DITED BY MONICA ROMAN

HEADLINER

ANDREW LIVERIS

CHEMICAL AGENT

or the second time, Dow hemical Chairman William tavropoulos is handing over is chief executive duties. ndrew Liveris, Dow's resident and chief operating fficer since last November nd a 28-year company eteran, will take over as CEO f the nation's biggest hemical company on Nov. 1.

Liveris, 50, should have it asier than Stavropoulos' arlier pick. Michael Parker, amed chief in 2000, lasted nly two years before tavropoulos reclaimed the ob after the recession led Dow into back-to-back nnual losses. Today, with emand for chemicals and lastics rebounding, the Midland (Mich.) giant is gain in the black. Cost-utting helped: After lumping 3,500 jobs in 2003, Dow plans to axe another ,000 this year, leaving a otal of 43,000.

Still, Liveris faces chal-enges. Natural gas and oil ost Dow $3.5 billion in the econd quarter, up 20%. The veaker dollar, which has elped earnings, is also level-ng out. Liveris knows, too, that he chairman will be watching.

–Michael Arndt

BRISTOL'S BITTER PILL

Bristol-Myers Squibb is breaking out its checkbook to resolve its accounting scandal. On Aug. 4, the company reached a settlement with the **Securities & Exchange Commission** under which Bristol will pay a $150 million fine. The SEC alleged that the company used a variety of tactics, including selling excessive amounts of its products to wholesalers, to meet Wall Street earnings expectations. The SEC said it is continuing to investigate certain executives. Bristol, which did not admit or deny any liability, says a probe into the matter by the Justice Dept. is continuing. On July 30, Bristol struck a $300 million settlement of a class action involving, among other things, the alleged improper accounting.

THE SOUFFLES KEEP FALLING

With the prospect of jail time already dampening Martha Stewart's birthday party, her company served up another blow with a bigger-than-expected loss for the second quarter. On Aug. 3, the same day that its founder turned 63, **Martha Stewart Living Omnimedia** reported a loss of $19.29 million, or 39¢ a share, compared with a paltry profit of $931,000 the year before. Sales dropped by a third, to $44 million, during the same period. One culprit was a defection of advertisers and readers from the flagship *Martha Stewart Living* magazine, which has run few references to its founder since her federal criminal conviction. But poor results in the TV segment and merchandising, a former bright spot, also dragged down results. Her recipe for renewed vigor: more layoffs, expanding the *Everyday Food* magazine into television, and a vow to clear her name in court.

HAVE TiVo, WILL TRAVEL

Little **TiVo** won a nasty battle over the Hollywood studios. On Aug. 4, the **Federal Communications Commission** approved the first set of new technologies to distribute and record digital TV shows under the so-called broadcast flag rule that it passed last November. The **Motion Picture Association of America** and the **NFL** objected vehemently to TiVo's proposal to allow up to 10 registered TiVo devices to send copies of digital TV shows to each other. The FCC determined that TiVo's scheme wouldn't violate the broadcast flag rule, because it wouldn't lead to mass, indiscriminate distribution of copyrighted content.

A MENTOR ON THE MEND

Steve Jobs plans to return to work as CEO of **Apple Computer** and **Pixar Animation Studios** in September. Until then, he'll be recuperating from surgery to remove an islet cell neuroendocrine tumor, a rare form of pancreatic cancer that is usually curable if caught early. In an e-mail to Apple employees from his hospital bed on Aug. 1, Jobs said the surgery was a success, and that he was not expected to require chemotherapy or radiation treatments. "The prognosis is excellent, and that's a quote from his doctor," says Apple board member Bill Campbell.

ET CETERA...

» **GM** is offering $6,000 on some models, including a bonus of up to $1,500 for financing through **GMAC**.

» Ronald Drapeau resigned as CEO of **Callaway Golf.**

» **Eli Lilly** got approval for Cymbalta, a new anti-depressant intended to succeed Prozac.

CLOSING BELL

Shares of Coach fell 11%, to $38.12, in the two days ended Aug. 4 after the handbag maker reported fourth-quarter profits up 120%. Investors are worried about slowing sales in Japan; many also appear to be taking profits after a 63% runup in the stock in the past 12 months.

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)ITED BY MIKE McNAMEE

;s There Life After November for 527s?

DEMOCRATIC PRESIDENTIAL NOMINEE John Kerry wins on Nov. 2, he ay owe his success to a handful of tax-exempt organizations at were little more than a liberal pipe dream a year ago. The rgest—America Coming Together (ACT), the Media Fund, and loveOn.org Voter Fund—are backed by wealthy individuals ping to drive George W. Bush from of-e. The three have bought $33 million in ti-Bush TV ads and spent $85 million to gister new voters and explain the liberal w on issues from health care to trade. here has never been anything like this ıgnitude of voter contact in history," says T CEO Steve Rosenthal, who ran a simi- operation for organized labor.

Now 527s—as the groups are called after e tax-code section that created them—pe to use the election as a jumping-off int for a grassroots movement. But their rrent momentum aside, a triple threat ›ms, ranging from loss of funding to hter regulatory oversight and a possible ngressional crackdown.

The biggest problem is that success ıld spoil the 527s' ure. If Kerry wins, ances are their Bush-sessed sugar daddies ll lose a lot of interest. ising even one-fifth the $200 million or they expect to garner s cycle could be hard. T insiders doubt that dge-fund impresario orge Soros, the top nor, would pony up ıch more than the 2.8 million he's given e three major committees so far. Soros okesman Michael Vachon says his boss s not made up his mind about sending ecks after Nov. 2, but adds that he "is un-mfortable with the partisan mantle that s been thrust on him."

Soros may rest his checkbook come November

If Bush wins, the 527s' funding chances prove because they can argue that they ed money to stay in fighting trim for 08. But a Bush victory would increase e legal and legislative threat. The liberal 7s walk a fine line: Though they accept unlimited soft money and operate outside election laws, they openly work toward Bush's defeat. They skirt the law by being careful not to advocate voting for or against any candidate. Some legal experts argue that the 527s are splitting hairs and should follow the same fund-raising and spending limits as other political committees—not just loose disclosure rules set by the IRS. "[They] are knowingly and willfully violating the law," says Mark Glaze of the nonpartisan Campaign Legal Center.

The Nine Lives of Soft Money

IN MAY, the Federal Election Commission declined to regulate the 527s, but it could return to the issue later this month—though no rules would take effect until 2006's midterms. The heat is on the FEC to act. GOP Senator John McCain, who co-wrote the reform law that inadvertently encouraged 527s, is pushing legislation to reduce the FEC's power—a direct response to its May vote to punt. And Senator Trent Lott (R-Miss.), who oversees the FEC as chairman of the Senate Rules Committee, may seek to bar 527s from using soft money—especially if they boost turnout and are credited with a Kerry win.

Harold M. Ickes, who helps run ACT, believes it "will carry on." Under a Kerry Administration, ACT could raise grassroots support for Kerry's health-care plan. If Bush wins, it could mobilize opposition to Social Security privatization. But first, ACT and its peers will have to replenish their coffers, keep the FEC at bay, and calm a possible congressional backlash. Only then will they live to fight another day. ■

–By Paula Dwyer

CAPITAL WRAPUP

PHISHING FOR KERRY DONORS

INTERNET SCAMSTERS have found new targets for "phishing" schemes: political donors. Less than two days after **John Kerry** accepted the Democratic Presidential nomination, an e-mail hit the Internet purportedly soliciting donations to his campaign. The plea looked legit—it featured a picture of the candidate's brother **Cameron Kerry** and a letter asking for funds to "fight back against George Bush." But MailFrontier, an e-mail security company in Palo Alto, Calif., noted that the "secure donation" link went to a Web site registered in Jaipur, India. The campaign warned would-be donors of the scam and called in the FBI.

MILLIONAIRE EQUALIZER

FORMER HOUSING & Urban Development Secretary **Mel Martinez** sent donors a news flash in early August: They can write bigger checks to his campaign for the GOP Senate nomination in Florida. One of Martinez' primary opponents is computer software executive **Doug Gallagher**, who has poured more than $2.5 million into his own campaign. That spending triggered the "millionaires' amendment," a provision in the McCain-Feingold campaign-finance law designed to help candidates facing rich opponents. Martinez, who has access to President Bush's big funders, can now take gifts of up to $6,000, three times the normal limit. The same provision boosted funding for **Barack Obama**, keynoter at the Democratic convention, when he won the seven-candidate race for the Dems' Senate nomination in Illinois.

MPHASIS GUARD State-of-the-art systems to wat workers' every m

INDIA

FORTRESS INDIA?

Call centers and credit-card processors are tightening security to ease U.S. and European fears of identity thef

A LINE OF NEATLY dressed workers files into the Golden Millennium, a shimmering glass-and-steel building in central Bangalore. One by one, they swipe ID cards through a reader, then empty their pockets and bags and stuff cell phones, PDAs, and even pens and notebooks into lockers as a dour security guard watches. Staffers ending their shifts, meanwhile, are busy shredding notes of conversations with customers. At the reception desk, visitors sign a daunting four-page form promising not to divulge anything they see inside—and even then are only allowed to peer into the workspace through thick windows.

A top-secret military contractor? Hardly. This is one of four call centers run by ICICI OneSource, which employs 4,000 young Indians to process credit-card bills and make telemarketing calls for big U.S. and European banks, insurers, and retailers. And ICICI isn't the only outsourcing company worried about security. Call center operators such as Mphasis BFL, Wipro Spectramind, and 24/7 Customer, as well as back-office subsidiaries of companies such as General Electric, are quic adding state-of-the-art systems to moni phone conversations, guard data, a watch workers' every move.

Why the extreme caution? After rus ing to shift telemarketing and back-off work to India in recent years to tap l wages, U.S. and European companies under growing pressure from regulat and legislators to guarantee the privacy their customers' financial and health-c data. India's $3.6 billion busine process services industry is eager to fuse the issue. When the backlash agai offshore outsourcing erupted last ye

ponents first focused on curbing gov-
ment contracts and temporary U.S.
rk visas for foreign tech workers. Now
urity and privacy fears have become
hot excuses "for new barriers to trade
services and information technology,"
s Jerry Rao, chairman of the National
sociation of Service & Software Cos.
asscom), India's IT trade group.

NDING LEGISLATION

DAY 186 BILLS that aim to limit off-
re outsourcing are pending in the U.S.
ngress and 40 state legislatures.
zens of those involve restrictions on
nsmission of data. For example, the
FE ID Act, sponsored by Senator
lary Clinton (D-N.Y.), and a similar
use bill by Representative Edward J.
rkey (D-Mass.), would require busi-
sses to notify U.S. consumers before
ding personal information overseas—
would bar companies from denying
vice or charging a higher price if cus-
ers balk. Although no such bills have
n enacted so far, "next year I think all
this legislation will be back and spike
again as a huge issue," especially if the
. recovery stalls, says R. Bruce Josten,
J.S. Chamber of Commerce executive
e-president who helped industry fight
legislation.

Identity theft and credit-card fraud are
ge problems globally. There's little evi-
nce, though, to suggest consumer data
at any greater risk in India than in the
. Sure, India's privacy laws aren't as
ingent as in the West. But most highly
sitive data belonging to U.S. or Euro-
n companies are stored on their own
vers at home, with access from India
htly controlled. If an American is de-
uded, the U.S. company that farmed
t the work is legally responsible. Indian
l centers, meanwhile, sign their con-
cts in the U.S. and can thus be sued
re by their corporate customers.
at's more, there is only one known
e of fraud. Last year a programmer for
dia's Geometric Software Solutions Co.
ed to sell a U.S. client's intellectual
perty. He was arrested and is awaiting
al in India.

Still, given the charged emotions over
tsourcing, India's IT industry knows
n a few incidents will generate devas-
ing publicity. So call centers like
phasis BFL Ltd., which employs 6,000
rkers performing sensitive tasks such
processing personal tax returns and
dit-card statements for U.S. clients,
leaving little to chance. If the U.S.
mpany prefers, consumers' names,
cial Security numbers, and credit-card numbers can be masked. Computer terminals at Mphasis lack hard drives, e-mail, CD-ROM drives, or other ways to store, copy, or forward data. Indian accountants only view data from U.S. servers for specific tasks. Video cameras watch over the sea of cubicles. Every phone conversation is recorded and can be monitored on a system installed by Melville (N.Y.)-based Verint Systems Inc. And since data theft is often committed by disgruntled former employees, Mphasis can lock a staffer out and cut access to PCs and phones three minutes after a resignation. A year ago that process took three days. "Fears about identity theft can be aggravated when people learn their data are in a foreign country," says Mphasis Vice-Chairman Jeroen Tas. "So we feel it is better to address these concerns up front."

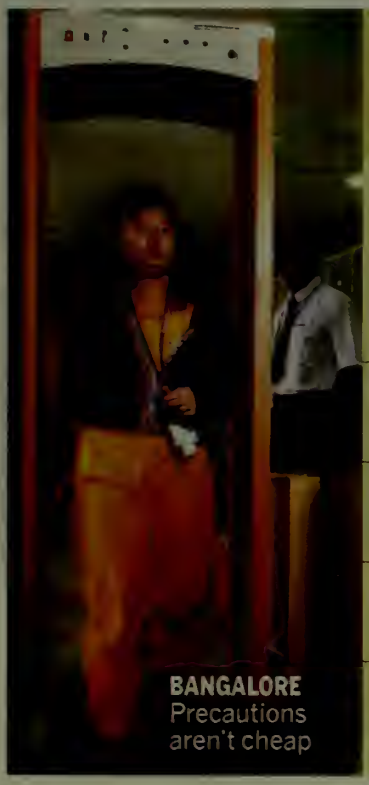
Among the most sensitive work: Processing tax returns

Such precautions don't come cheap. It costs about $1,000 per worker to install the Verint system that records, stores, and analyzes voice conversations. Yet Verint has signed up 100 local and multinational centers in India. "There has been a big push in the past year or so as the competition focuses more on quality," says Mariann McDonagh, Verint's vice-president for global marketing. Indian centers also pay up to $300 per worker for background checks, a big expense given their explosive growth and high attrition rates. It's also cumbersome: Due to India's lack of online databases, verifying education and work experience can take weeks.

But while security practices in India now match or surpass those at most U.S. call centers, the legal system still needs work. Indian law on computer hacking inside companies is fuzzy, and privacy enforcement is weak. India's IT industry is addressing those vulnerabilities. Nasscom is working with the government to bring India's data-privacy laws more in line with the U.S. And it intends to have the security practices of all its 860 members audited by international accounting firms. Nasscom has helped Bombay's police department set up a cybercrime unit, training officers to investigate data theft. Similar units are planned in nine other cities. India's goal, says Nasscom Vice-President Sunil Mehta, is "to have the best data-security provisions and be a trusted sourcing destination."

Given the ingenuity of today's cyberscammers, some embarrassing incident seems inevitable. But India's IT-services industry is determined to show that the world's financial and health secrets are as safe in Bangalore as they are anywhere. ■

–By Pete Engardio in New York, with Josey Puliyenthuruthel in Bangalore and Manjeet Kripalani in Bombay



BANGALORE Precautions aren't cheap

Outsourcing Lockdown

Measures Indian call centers are taking to guard against data theft:

BACKGROUND CHECKS Centers are hiring international security companies to verify education and work-experience claims made by job candidates.

ACCESS CONTROLS Staffers need electronic ID cards or fingerprint scans to enter call centers and must leave cell phones, notebooks, and even pens outside.

DUMB TERMINALS Workers handling sensitive U.S. consumer data use computers with no hard drives, e-mail, or printers, making it hard to filch information.

AUTOMATIC LOCKOUT Former employees can be security risks. So when a staffer quits, access to computers, e-mail, and buildings is cut off in minutes.

LAW ENFORCEMENT Info-tech companies are working with the government to beef up data-privacy-protection laws and training police to combat cybercrime.

FRANCE

MICHELIN: NEW RUBBER HITS THE ROAD

Its PAX tire runs a long way when punctured, but can it win blowout sales?

ALMOST A HALF-century ago, Groupe Michelin sparked a revolution in the tire industry when it introduced the steel-belted radial. Now it's hoping for another coup with the new PAX "run-flat" tire, which can keep rolling smoothly up to 120 miles even if completely deflated by a puncture. Michelin and Honda Motor Co. aren't commenting, but industry sources say that in September the tire will for the first time become standard equipment on a mass-market vehicle: Honda's Odyssey, the No. 2-selling minivan in the U.S.

PAX—OF MIND
Breakthrough?

It's the French tiremaker's biggest new product push since the radial. Certainly, the appeal of a run-flat is clear to any driver who has changed a tire on the shoulder of a busy highway or wished the spare didn't take up so much room in the trunk. Already, Michelin is predicting that the PAX will one day dominate the $70 billion-a-year tire market, much as radials now command nearly 100% market share in the industrialized world. "Like the radial, the PAX system is a groundbreaking innovation," says Chairman Edouard Michelin.

But Michelin, the global No. 1 tiremaker, has some catching up to do. Until now the dominant run-flat design has been the SST, or self-supporting tire, so called because its reinforced sidewall bears the car's weight in case of a flat. Goodyear Tire & Rubber Co. developed the first such tires, but most manufacturers, including Michelin, have their own versions. SSTs account for over 90% of the estimated 3 million run-flat tires sold annually. They're standard equipment on BMW's 6 Series and a popular option on BMW's hot-selling Mini Cooper. "SST is really where the volume is," says William M. Hopkins, global vice-president for product planning at Goodyear.

Michelin is gambling on a different idea. The PAX system, developed at the company's headquarters in Clermont-F rand, France, has a tough but flexible r ber ring attached to the wheel rim; it b the car's weight if the tire goes flat. T eliminates the need for thicker, more-r sidewalls, which in turn improves h dling and fuel economy. When flat, the can run more than twice as far as an S In Europe it sells for about $150, or u 25% more than a traditional tire. But S cost about as much. While Michelin is only tiremaker now building the PA has licensed the design to Goody Pirelli, Sumitomo, and Toyo Tire & R ber. If the PAX takes off, Michelin pocket a share of every sale.

How It Works

When deflated, Michelin's PAX tire runs on a tough but flexible interior ring.

CALLING ALL SUV OWNERS

THERE'S A BIG catch, thou Whereas SSTs can be put on m existing cars, the PAX works o on vehicles with a specially signed chassis and wheels. "[P is a little too complex for the m ketplace," says Mike Mart original equipment sales pr dent at Bridgestone/Firest North American Tire LLC. A because a PAX-modified car c accept traditional tires or SST customer with a flat must find authorized PAX outlet to repai replace the tire. Michelin say has 1,000 PAX dealers and re outlets in the U.S., includ round-the-clock service for r torists stranded in remote spot similar network exists in Euro

European car buyers h been wary. Audi, the only a maker now offering the PAX passenger cars, says few c tomers have bought them as an opti Renault used the PAX as standard equ ment on a limited series of its Scé minivans but discontinued the series ter selling about 30,000 vehicles. Wh more, nearly one-third of buyers insis on having a spare tire and jack in the c

Michelin is really pinning its hopes the U.S. market. Ordinary SSTs are strong enough to support heavy sp utility vehicles and pickups, but the P works just fine on them. Honda's cho of the PAX for its Odyssey minivan is a opening to this market. Adding to Mic lin's confidence are its finances: In first half, sales grew 6.4%, to $9.4 billi and profits doubled, to $396 million.

Michelin's radial, patented in 19 paid off handsomely. The PAX still has prove itself. But if it does, Michelin co have a smooth ride for years to come.

–By Carol Matlack in Pa

EXICO

MADE IN THE MAQUILAS—AGAIN

stronger U.S. economy and cheaper eso bring export factories back to life

A YEAR AGO IT LOOKED as if Mexico's *maquiladora* industry was in a state of irreversible decline. But that was then. Today, an expanding U.S. econo—the destination for 90% of Mexican orts—is fueling record growth in the de-for-export factories. With orders for rything from refrigerators to autos pil in, plants are hiring again after a re than two-year lull. The new momtum in manufacturing, along with ring oil prices, recently prompted xican officials to notch up their 2004 wth forecast to as high as 4.25%. e're in full recovery and we expect to p growing," says Maria de Lourdes ña, director of foreign commerce at xico's Economy Ministry.

Mexico's *maquiladora* sector accounts nearly half the country's total exports, f it thrives, Mexico thrives. Until retly, though, scary things were happen. Since *maquila* employment peaked in ober, 2000, a quarter-million jobs e been lost. More than 500 *quiladoras* have shuttered operations h most production being relocated to na, where factory hands earn one-d what their Mexican counterparts do.

SS RED TAPE

T THE SECTOR IS showing more stay power than expected. In June the ntry's 2,900-plus *maquiladoras* exted goods worth $7.72 billion. That's % higher than a year ago and a monthecord since Mexico first launched the *quila* program 40 years ago. Around 000 new *maquila* jobs have been led this year.

What's going on? The U.S. recovery, for rters. But a cheaper peso—it has ped around 8% against the U.S. dollar in the past 12 months—has also enhanced Mexico's allure for companies looking to trim costs. Sweden's Electrolux has just broken ground on a 1 million-square-foot facility in Ciudad Juárez that will employ 3,000 workers to manufacture refrigerators currently made in Greenville, Mich.

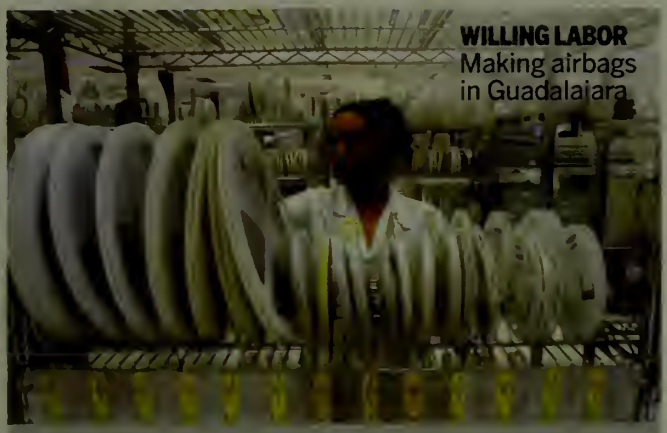
China continues to siphon off jobs and investment, but the government of Vicente Fox has begun to bridge the competitiveness gap. Heeding investor complaints, officials have postponed until 2008 a new fiscal regime that would require *maquiladora* owners to pay corporate taxes in Mexico. Customs procedures have been streamlined.

Another good sign is that China doesn't always win hands-down. Although most production that has migrated there is not expected to return, other manufacturers are staying put in Mexico after concluding that China's wage advantage does not compensate for the logistical difficulties of supplying the U.S. market from such a great distance. "People are starting to say: 'Yeah, China's great for that dollar-a-day labor, but I can't wait 30 days to get my product to a customer,'" says consultant Richard N. Sinkin of Inter-American Holdings Co., which is based in San Diego. High-tech companies also cite China's weak protection of intellectual-property rights as a reason for remaining in Mexico.

The country also got an unexpected boost from the U.S. Commerce Dept., which in June hiked duties on Chinese-made TV sets to as much as 78.45% to combat dumping. The measure is a boon for Japanese, Korean, and Mexican TV manufacturers based in Tijuana and Ciudad Juárez. "It will definitely help us when we start exporting TV sets to the U.S. next year," says Carlos Jaramillo, director of Diamond Electronics, a maker of 14- to 34-inch-screen sets with some $50 million in sales.

Unfortunately, there's no quick fix for Mexico's skills deficit, a result of decades of inadequate spending on education. Roughly 1 million Mexicans enter the labor force yearly, but most lack the training needed for increasingly sophisticated assembly lines. "You can't come to a small town in Mexico and find computer-skilled machinists," says Ed Mason, director of Mexico operations for Tempe (Ariz.)-based SmithWest Inc., a maker of jet-engine components that opened a factory in Guaymas five years ago. But even Mason is a believer. "We've found the people are very trainable and willing to learn," he says. Today a dozen U.S. aerospace suppliers have joined SmithWest in Guaymas. Mexico still has a chance. ■

–By Geri Smith in Mexico City



WILLING LABOR Making airbags in Guadalajara

Staying Power

The export plants are giving Mexico a lift. Here's why:

EXPORTS Up 20% in June from last year, a record high

EMPLOYMENT Up 5% this year after falling to a record low in 2003

JOB SHIFT Some work is moving from China to bypass U.S. duties

PESO Depreciated 8% over past 12 months, lowering operating costs for manufacturers

GOVERNMENT Mexico City is easing tax rules and streamlining customs transactions to attract investors

Data: National Institute of Geography & Statistics, Bank of Mexico

The McGraw-Hill Companies

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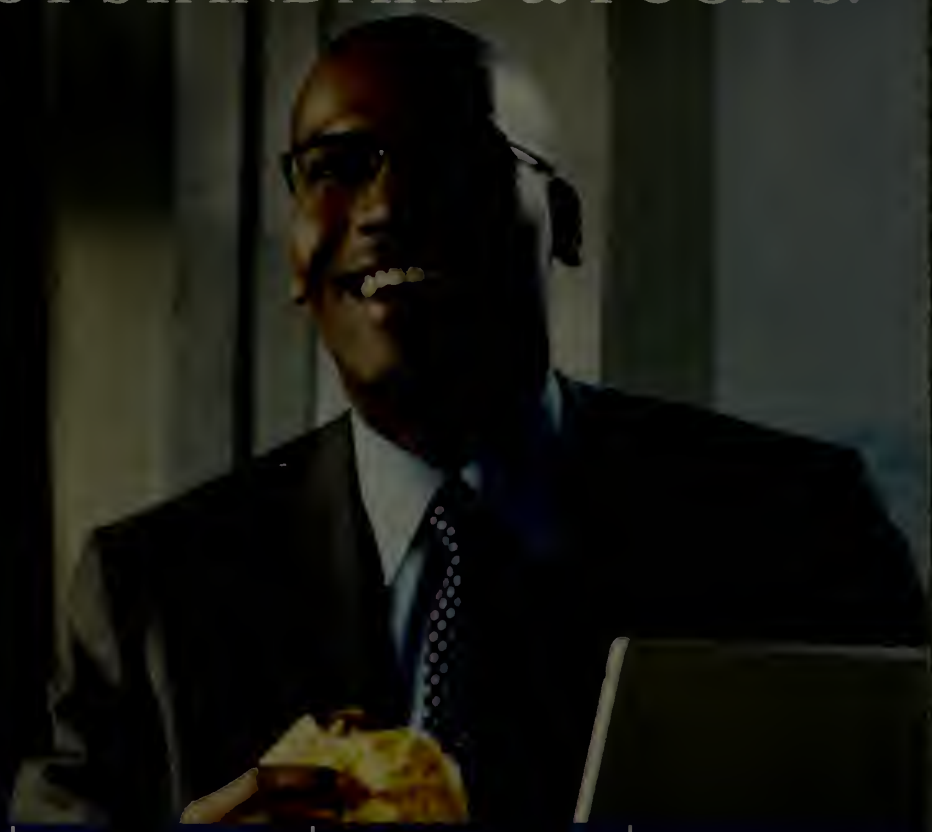

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ITED BY PATRICIA KRANZ

The Kinks in Russia's Oil Pipeline

TH GLOBAL OIL PRICES FLIRTING with a record $44 a barrel, the ath throes of Russia's Yukos could hardly have come at a more nsitive time. OPEC producers, whose output hit a 25-year high July, have little room to ramp up production to meet surging mand. Other global oil players face similar capacity constraints.

n late July the markets panicked when kos said its tussle with authorities over ions in unpaid taxes could lead to a halt production. But a change in owner-p—even some form of renationaliza-n—doesn't necessarily mean Yukos will p pumping crude. Oil analysts in scow expect the Kremlin will bend over kwards to avoid any Yukos-triggered ruption in Russia's oil production: "The itical effects would be astronomical," s Ronald Smith, oil analyst at Moscow estment bank Renaissance Capital. Jus- Minister Yuri Chaika rejected Yukos' ims that production would be affected. officially declare that there will be no blems," he said on y 28.

Even if there is a duction snafu, te-owned pipeline npany Transneft ld make up any rtfall to foreign tomers by increas- supplies from oth- oil companies. The ntry, in fact, is do- its very best to ply global cus- ners. According to U.S. Energy Infor- tion Administra- n, from 1998 through 2003, Russia's tput jumped 40%, to 8.4 million barrels ay, and exports grew 62%, to 5.8 million rels a day. Russia's Industry & Energy nistry reports that so far this year oil tput grew 10%, with exports rising 20%. But markets should still worry about ssian oil. Unless Russia builds new elines, growth in oil exports will slow matically as early as next year. Major w pipelines are not expected to be ready at least three years.

PUMPING Yukos' legal woes haven't slowed production

The second issue involves the long-term consequences of Yukos' fall. Russian Economy Minister German Gref said on July 22 that "the government is not contemplating purchasing Yukos assets." But growing evidence suggests that the Kremlin plans to renationalize Yukos' oilfields indirectly. Igor Sechin, a KGB veteran and senior Kremlin aide, was recently appointed chairman of Rosneft, Russia's last remaining state-owned oil company. Analysts think that under Sechin, Rosneft is being positioned to purchase choice Yukos assets in a forced sale of the company's properties to satisfy its huge tax bill. "The government has been pursuing a course that gives them legal justification for taking assets from Yukos," says Chris Weafer, chief strategist at Alfa Bank.

Investment Chill

HOW WOULD renationalizing Yukos affect oil production? Simple: There's clear evidence that the country needs private companies spurred on by the profit motive to realize its oil potential. According to the Organization for Economic Cooperation & Development, the three largest oil companies owned by private financial groups (Yukos, Sibneft, and TNK) increased their combined production by 90% and exports by 130% between 1998 and 2003. During the same period, however, Russian state-owned oil companies managed increases of just 15% in production and 27% in exports. If Yukos is dismembered, the surviving private companies are bound to think twice before investing. Global oil markets—and Russia—would suffer as a result. ■

–By Jason Bush in Moscow

GLOBAL WRAPUP

A COMEBACK FOR PRI?

JUST FOUR years after Mexican voters ushered in multiparty democracy by wresting the presidency from the Institutional Revolutionary Party's 71-year-old hold, the PRI's hard-line "dinosaurs" may be staging a comeback, capitalizing on voter frustration with President Vicente Fox's lackluster administration. In Aug. 1 elections, the PRI won the Tijuana mayor's office after 15 years of control by Fox's National Action Party. And it held on to the governor's seat in Oaxaca by employing the party's legendary get-out-the-vote organizational skills. The victories boost the fortunes of party President **Roberto Madrazo,** an old-style pol likely to be PRI's candidate in the July, 2006, presidential vote.

ITALY BITES THE BULLET

AFTER STANDARD & Poor's downgraded Italy's credit rating in July, the center-right government knew it had to take dramatic action. On Aug. 2 it approved $20.4 billion in spending cuts and $8.4 billion in one-time, revenue-raising measures to control the ballooning budget deficit. Italy's pragmatic new Finance Minister **Domenico Siniscalco** said the exact cuts would be hammered out in the fall, but they will inevitably pinch Italy's social welfare programs. Siniscalco also aims to sell $128 billion in state assets by 2008, including $20 billion this year. Sales could include the state's stake in utility Enel and energy company ENI. This year's $29 billion savings would hold Italy's 2005 gap to 2.7% of gross domestic product, keeping the budget within the European Union's Growth & Stability Pact guidelines.

Can Woody Make It In New York?

Jets owner Robert Wood Johnson has yet to sell New York on his football stadium

ROBERT WOOD JOHNSON IV, philanthropist and owner of the New York Jets, knows how to work a room. It's a warm June evening and Johnson is hosting a luau-themed benefit in New York to raise money to find a cure for the autoimmune disease lupus. Clad in a Hawaiian shirt, Johnson moves around the room, high-fiving one supporter and playfully grabbing the lei of another. Then he takes the stage with the night's honoree, James L. Dolan, chief executive of Cablevision Systems Corp. As they banter casually, it's barely apparent that the two men are actually engaged in a bitter war over Johnson's push to build a football stadium for the Jets in Manhattan.

Johnson will need all the diplomacy and persuasiveness he can muster. Four years after paying $635 million for the Jets, Johnson has teamed with New York state and city officials in a controversial proposal to build a $1.4 billion stadium on the west side of Manhattan. It would be the most expensive sports facility ever built in the U.S.

True, the 57-year-old billionaire heir to the Johnson & Johnson fortune is known for his relentless energy and unbridled enthusiasm, whether he's talking up biomedical research or handicapping the Jets' prospects this fall. But his stadium plan faces some powerful enemies, ranging from community groups to city and state politicians. What's more, New York's Madison Square Garden—a facility that's controlled by the Dolan family's Cablevision—has attacked the plan in television ads.

All this hubbub has thrust the normally press-shy Johnson into an unaccustomed spotlight. But Johnson—w goes by "Woody" because he deems full name "too serious"—seems to be joying the exposure. After turning a from the family business as a young n Johnson spent much of his early ad hood searching for a passion that wo excite him as much as running J&J driven his father and grandfather. Jets, coupled with his philanthropic v tures, have filled that void in his life think I'm finally there," he says.

The Jets, while far from a charity c definitely need help. Johnson, a lifel football devotee, bought the team in 20 following the death of longtime ow Leon Hess. Professional sports finan are rarely made public, but Marc Ga

KEVIN KNIGHT

CLUTCH PLAYER Johnson is active in diabetes and lupus fund-raising

esident of Chicago-based consulting n Sportscorp Ltd., estimates that once e cost of capital is factored in, the Jets ve actually been losing money ever ice Johnson bought the team.

Part of the problem is that the team has ousy deal with the Meadowlands com- x in New Jersey, where it shares a sta- um with the New York Giants. The Jets ly get a fraction of revenues from urces such as signs and luxury suites, th the rest going to the Giants and the w Jersey entity that runs the facility. d the rent the team pays is 15% of game eipts, vs. a National Football League rage of less than 10%. "They have one the worst stadium deals in the NFL," nis says. Not only would the new stadi- n sport more amenities like high-priced tes and club seats but the Jets would ep all the revenues from them.

MPETING CAMPAIGNS

HNSON'S POLITICAL TIES haven't rt his efforts to grab some prime New rk real estate. He's a big GOP fund- ser. In 2001 and 2002, Johnson gave 7,500 to New York Governor George E. taki's campaign. With New York City king to add convention center space d build a stadium as it bids for the 12 Olympics, Johnson was able to craft lan with the governor and New York ty Mayor Michael R. Bloomberg to are the cost of the facility.

It will take more than Johnson's politi- glad-handing to close the deal, how- r. Legislators in Albany threatened to to block the $300 million in state nding Pataki has pledged to the project. d some politicians are up in arms over ssible plans to allow the Jets to use tax- empt bonds to cover part of its stadium —a move they argue increases the al- dy generous subsidies going to the s. Dolan's Madison Square Garden ads New Yorkers whether the millions be- spent by the city should go to schools d other services instead.

The tactic irks Johnson. "They are unting a massive disinformation cam- ign," he says. Johnson believes the lans are only worried about a possible eat to Madison Square Garden. The lans referred questions to a spokesman the New York Association for Better oices, who says the cost to taxpayers is efutable" and that the ads are accu- e. Still, Johnson has kicked off his own campaign arguing the stadium will nerate enough revenues to cover the in- stment. Of course, with Los Angeles king to land an NFL team, Johnson uld always up the ante in negotiations.

He says he has no plans to move the team out of New York. But Jets President L. Jay Cross says with the Meadowlands lease up in 2008, if the team can't get a suitable stadium in the New York area, "We would have to explore all our options."

Johnson's feistiness doesn't surprise those who know him. An avid sailor, he competed twice during the 1970s in a race from Rhode Island to Bermuda—traveling through hurricanes so brutal "you thought the keel was going to come off." And he has driven across the country on his motorcycle with buddies such as *Rolling Stone* founder Jann Wenner and AOL Time Warner's former chief operating officer, Robert W. Pittman. Once, he and Wenner drove for one hour at the highest speeds the bikes could handle. "It was sunset, and we were hauling buns," he laughs.

A life of privilege, to be sure. But Johnson's formative years also were marked by tragedy. Johnson lost two younger brothers within months of each other when he was in his 20s—one to a drug overdose and the other in a motorcycle accident. His father, a onetime senior executive within Johnson & Johnson, had died a few years earlier at the age of 50. That death followed a nasty feud between Woody's father and grandfather, family patriarch Robert Wood Johnson II, who ran J&J from 1932 through 1963. Woody has one surviving brother and a sister, who along with his mother have stakes in the Jets. "The situation he grew up in was very difficult," says retired J&J Chairman James E. Burke, who took the helm at the company in 1976 and led J&J through the Tylenol tampering ordeal.

Determined to chart his own course, Johnson never pursued a career at J&J. He worked just one summer there as a teen. Johnson instead made a series of investments in the cable-television business and real estate in Florida, where he grew up, before moving to New York in 1984. There he began managing investments for several family members. In the 1990s, after one of his three daughters was diagnosed with diabetes, he began raising money for the Juvenile Diabetes Research Foundation. And he founded the Alliance for Lupus Research in 1999 when another family member was struck with the disease.

In many ways Johnson is more passionate about biomedical research than he is about football. He once hopped on a plane to visit a wealthy woman in Qatar who had a family member with diabetes. He returned with a $10 million donation for the Juvenile Diabetes Research Foundation.

Regardless of whether the subject is philanthropic or Jets-related, Johnson can get even his competitors to let their guard down. Robert Kraft, owner of the New England Patriots, who opened a stadium for his team in 2002, has allowed Jets executives to take a close look at his operations to help them plan for their own facility. "I wouldn't do that for everyone," Kraft says. "I trust Woody." The question is whether Johnson can convince skeptical New Yorkers to place their faith in him as well. ■

–By Amy Barrett in New York

BIO

Robert Wood Johnson IV

A mix of passions: Philanthropy and football

BORN April, 1947, New Brunswick, N.J.

EDUCATION B.A., History, University of Arizona, 1972.

CURRENT POSITION Owner of the New York Jets and chairman of the Alliance for Lupus Research.

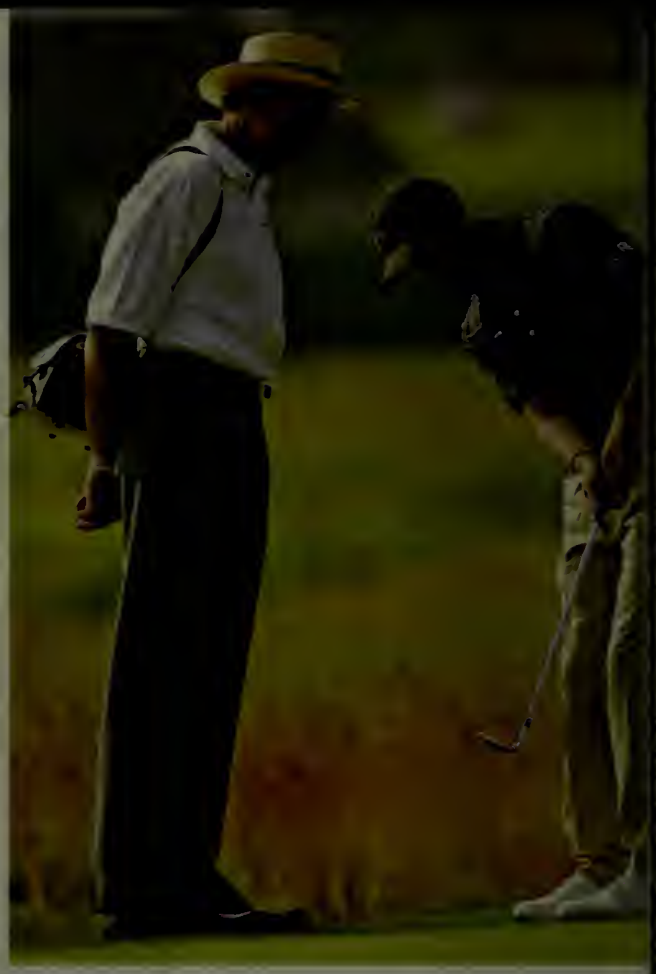
BIGGEST MISTAKE Passed on making a bid for the Tampa Bay expansion team in the mid-70s when the franchise was sold for $16 million. Paid $635 million in 2000 to buy the New York Jets.

FAMILY TIES Still holds a large but undisclosed percentage of his personal wealth in Johnson & Johnson stock, the company founded by his great grandfather Robert Wood Johnson. He serves on the board of the $8 billion philanthropic Robert Wood Johnson Foundation.

PERSONAL Divorced. Three daughters.

The Gurus Are Cashing In

With endorsements and high fees, coaches spin fame into gold



SWING DOC Leadbetter with longtime pupil Howell

FAME FOLLOWS BUTCH Harmon most places these days. Sometimes even he's surprised how far. Recently, Harmon, the golf swing guru who tutored Tiger Woods, was in the lingerie aisle at the Nordstrom's near his Las Vegas home when two female fans came by to pay homage. "I had to explain I was waiting for my wife," he says.

David Leadbetter, Harmon's main rival in the golf instruction wars, gets similar star treatment when he shows up at tourneys. "He'll get asked to sign autographs just as much as the players," notes Charles Howell III, a PGA Tour star and longtime pupil of Leadbetter.

Golf coaches as sports icons? Would you believe even sought-after pitchmen? That would have been a hoot a generation ago, when Deke Palmer was tutoring his son Arnold, and the pro at the country club where Jack Nicklaus learned to play was his teacher. Now an elite group of golf-swing gurus have spun fame into budding brands and seven-figure incomes. Some of the other top gurus include Hank Haney, Jim McLean, and Rick Smith, but Harmon and Leadbetter stand out for their endorsement deals beyond traditional golf companies.

A visit to Mr. Harmon's neighborhood doesn't come cheap. The coach, who floundered as a PGA Tour player from 1969–71, worked at a series of clubs, and came to prominence after coaching Greg Norman in the early '90s, has given lessons to Bruce Willis and Roger Clemens, and helped Morocco's late King Hassan II knock his handicap down to a six. Alas, he isn't taking new students right now. If price isn't an object, though, you might book him for an outing. Harmon, 60, does four to five full-day teaching, playing, and speaking engagements a year. The price: from $40,000 to $60,000.

That's not too high for acolytes wowed by Harmon's credentials. These days the blunt, opinionated swing coach gives tips to world-class players Darren Clarke, Adam Scott, Fred Couples, and Mark Calcavecchia. Until their acrimonious split in 2002, Harmon and Woods were a devastating team, at one point racking up wins in four consecutive major championships. The partnership fizzled amid whispers that Woods's handlers regarded Harmon as a publicity seeker. "In Tiger's camp, they don't like you talking to anybody. That's not the way I am," says the coach.

Since the divorce, Woods has slowed down, but Harmon, the son of Claude Harmon, the 1948 Masters champion, hasn't. Butch has a Web site (butchharmon.com) and a golf school in Nevada where he teaches 36 two- and three-day sessions a year. His instructional book, DVDs, and teaching aids round out the product line.

But these golf gurus aren't selling just swing secrets. Harmon has endorsement deals with companies including Winn Inc., a manufacturer of grips golf clubs; Flemings, for which he p motes a line of alligator belts that start $665; even Balance Bracelet, a metal c that supposedly comforts arthritis suff ers like Harmon.

Even so, the clubhouse leader amo brand-building coaches is Leadbetter lean, 6-foot-4-inch Englishman whose fa ily moved to Rhodesia (now Zimbabw when he was 7. Leadbetter tried but fail to measure up as a player on the Europe and South African Tours. In 1979 moved to the U.S. and soon was giving g lessons at a resort course near Orlando.

The last thing Leadbetter was strivi for at the time was a killer brand. "His l was devoted to teaching golf. He had other interests," recalls Tom Stine, a lon time friend and board member of Dav Leadbetter Enterprises. But it was long before Leadbetter began showing on tour, videotaping players as they hit the practice tee, and offering pointe Soon international stars like Nick Fal and Nick Price were soliciting advi When, under Leadbetter's tutelage, Fal won the British Open in 1987, his g teacher stepped out of the shadows.

Now, Leadbetter's cadre of studer reads like an intriguing leaderboard the Aug. 12-15 PGA Championshi Aaron Baddeley, Ernie Els, Ian Poult

THE STAT

$5,000

What Leadbetter gets for a day, including four hours with him

ıd Justin Rose, in addition to Howell. ichelle Wie, the 14-year-old sensation, so is in the Leadbetter camp—and wore Leadbetter cap during the recent U.S. omen's Open.

ELLING A LIFESTYLE

NLIKE HARMON, Leadbetter accepts w students. He charges $5,000 for a day at includes a four-hour session with him. don't want to be thought of as untouch-le," he says. But lessons aren't the only ıbs in Leadbetter's bag anymore. Sitting a small corner office at the Orlando hool, where the windows open onto an panse of practice tees and fairways, he irps about the new golf course he's de-gning in China. And he plugs the chain 26 Leadbetter Academies, golf schools ıffed by 57 "certified" Leadbetter in-ructors teaching golf his way. Many of e schools are in dreamy resort settings e Whistler in Western Canada, where irmont Hotels & Resorts Inc. opened a adbetter Academy, a lure for free-spend-g golf vacationers, in June, 2003.

As much as a smooth golf swing, adbetter's brand sells a lavish lifestyle. nong his corporate sponsors are Cadil-c—he drives a jet black Escalade—and olex, which supplied an oversized time-ece that hangs above the Orlando ademy's main entrance. Leadbetter so has appeared in Rolex advertising, have golfing gods like Palmer and icklaus. "We look at David as a pio-er," says a Rolex spokesman.

VIDENDS
armon in a print d for Winn grips

Jos. A. Bank looked at Leadbetter as a fashion icon. In 1997 the Hampstead (Md.) clothier signed Leadbetter and came out with golfing fashions that now include shirts, trousers, even Leadbetter fleece pullovers. The deal got Bank into the golfwear business at a price well below the $20 million a year that Nike pays Woods.

While many Leadbetter items listed on ank's Web store are marked down, most ods with his name attached seem to be ing off the shelves. "People say to me, an I shake your hand so some of that nagic] rubs off?' I suppose they're buy-g hope," he says. And ideally, a watch, a lt, and a golf vacation as well. ■

—By Mark Hyman in Orlando

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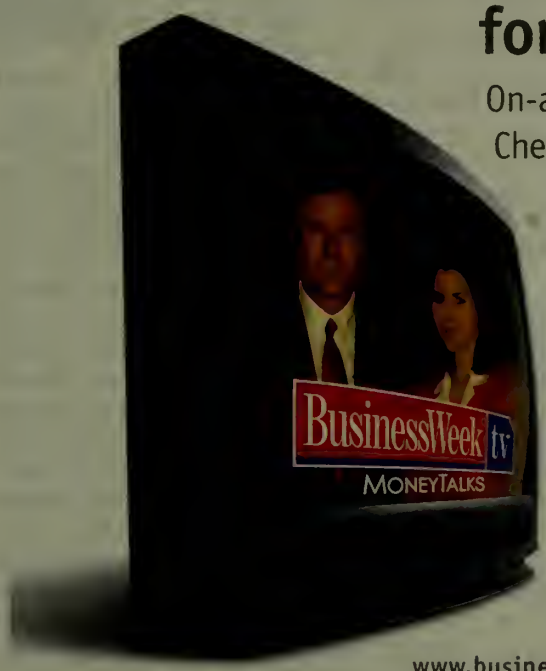

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For Every Gizmo, A TI Chip

Texas Instruments CEO Rich Templeton is looking way beyond cell phones

IT COULDN'T HAVE BEEN THE coming-out party that Richard K. "Rich" Templeton wanted. On July 20, the 45-year-old chief executive of Texas Instruments Inc. presided over his first quarterly earnings report since taking over in May. Sales at the semiconductor giant surged 39%, to a record $3.2 billion, for the second quarter, while net income more than tripled, to $441 million. "It really represents how strong the markets are that we serve," Templeton said. Yet the next day, TI's shares sank 5%, to $20.61. The culprit: a slowdown in TI's orders late in the quarter and a rise in inventories. "That was enough to basically tell investors: 'Run for the hills,'" says American Technology Research Inc. analyst Erach Desai.

Templeton is taking the helm of the world's No. 3 chipmaker in treacherous times. Skittish investors are scattering at any sign from the semiconductor industry that the young recovery in tech spending is sputtering. And there have been a few of them recently: flattening profit margins at Intel, glitches at one state-of-the-art IBM factory, and TI's revelation of a slowdown in demand. Meantime, TI is in the crosshairs of powerful rivals—Qualcomm in particular—which are redoubling their efforts to unseat the Dallas company as the top provider of chips for mobile phones and other wireless devices.

Templeton's battle plan could be called Convergence Inc. He's betting that TI can be the premier arms dealer in the war to supply consumers with a new generation of gadgets. Not only does TI have the experience and leadership in mobile phones, but it also has the engineering talent to supply the innards for digital cameras, broadband modems, and the new wireless technology known as Wi-Fi. Put them all together, and TI can help Nokia, Motorola, Hewlett-Packard, and others develop entirely new devices for Digital Age consumers. Already, TI and its partners are working on mobile phones with high-resolution cameras, handheld computers that can make voice calls over the Internet—even phones that can download a John Coltrane tune over a wireless Net link and then play it while on the run. "We see a world where every phone call is made across a TI [chip], every picture is captured with a TI [chip]," says Templeton. "If you weren't working on this 10 years ago, you're coming from way behind."

TI is making inroads in everything from flat-screen TVs to cameras

That strategy should keep TI solidly on track—provided the semiconductor industry doesn't crack. The company will benefit from strong mobile-phone sales, expected to rise 20% this year, to 625 million phones, according to researcher iSuppli Corp. TI gets an added benefit as those phones take on new capabilities: It can sell one chip to process voice calls and another to handle camera functions or other tasks. That means TI can pull in two to three times as much revenue from new, sophisticated phones as it did from the voice-only phones of the past. TI's revenues are expected to rise 32% this year, to $13.0 billion, as net income soars 53%, to $1.8 billion, according to research firm Legg Mason Inc. "They're in a great position," says analyst David Lytel of independent research firm Precursor.

CONVERGENCE KING Templeton intends to help his clients develop new products

The change at the top has been a subt one, befitting the 74-year-old company quiet, conservative style. Like the last CE Thomas J. Engibous, Templeton has spe his entire career at TI. He joined in 198 after graduating from Union College i Schenectady, N.Y., about 100 miles nort of his childhood home in a suburb Poughkeepsie. In 1996, Engibous tappe the tall, hard-charging salesman to hel focus TI on digital signal processors, th brains of cell phones, as the company she businesses that made everything fro computer memory chips to complet laser-guided missiles. The restructurin worked, and profits soared. In 2000, Tem pleton was named chief operating off cer—just before the chip sector sank int its worst slump ever. He quickly naviga ed TI through the storm by cutting job and capacity. "He was very hawkis [about costs]," says Bill Eversole, a forme TI exec who is now CEO of Bandspee

A New **Sheriff** In Town

Texas Instruments' sales and profits are surging, but investors worry that a chip slump looms. Here's Templeton's plan to maintain TI's momentum:

WIRELESS To offset its dependence on Nokia, which accounts for 14% of TI's total revenue, Templeton is winning new business from Samsung, Motorola, LG Electronics, and Japanese giant NTT DoCoMo.

CONVERGENCE TI is becoming one of the biggest arms dealers in the battle to sell new digital gear with successful chips for broadband modems, digital cameras, MP3 players, and flat-screen TVs. High volume lets TI offer customers low costs. Flat screens with its chips go for half the cost of comparable plasma or LCD televisions.

ANALOG The world may be going digital, but Templeton has continued to expand TI's lucrative analog chip business. Three major acquisitions over the past four years helped build the business to $4 billion in sales and 10,000 customers—scale that helps it turn in above-average profits and stable growth.

COST CONTROL A hawk on controlling costs, Templeton is keeping TI's capital spending in check by outsourcing production of its most popular chips at peak times.

ıc., an Austin (Tex.) wireless startup.

Templeton made sure TI came out of ıe downturn swinging. He doubled the nount of time he spent with customers, aveling as far as Korea to listen to their ɔncerns. And he sent 2,000 employees ırough a two-day boot camp designed to lp them better understand customer ripes. Employees played the role of honemakers, agreed to certain launch ates, and then were told that TI couldn't ave the chips ready on time. "We wanted ıem to really feel the customers' pain," ıys Jeff McCreary, TI's head of sales. The lort paid off: As the industry reboundd, TI gained market share for two raight years. Even as its biggest cusmer, Nokia Corp., has seen its share ide, TI has picked up business from round-gainers such as LG Electronics nd Samsung Electronics.

Problem is, the torrid growth of the obile-phone market is drawing many rivals. Ericsson, NEC, Broadcom, and Freescale Semiconductor, Motorola's chip division that was spun off in July, all are working on new chips for high-speed wireless communications. Intel is expected to make another run at the market, despite a stumble in its initial effort last year. The most fearsome rival is Qualcomm, which has close ties with red-hot phonemaker Samsung and a head start in the intellectual property for what is known as third-generation, or 3G, wireless technology. "We have a significant lead," says Qualcomm President Anthony S. Thornley.

3G'S TWO TITANS?

NO QUESTION, TI and Qualcomm are on a collision course. TI dominates in the world's most popular wireless standard today, GSM, while Qualcomm is the top player in the second-most popular, CDMA. As the wireless world moves to 3G, the two companies will lay claim to the same turf. Sales of 3G phones are expected to hit 311 million in 2008, up from 150 million this year. Qualcomm believes it can grab 50% of the market for what's expected to be the most popular 3G technology, W-CDMA. Templeton says TI should be able to take as much share in W-CDMA as it has in GSM, or nearly 40%.

Qualcomm has a slight edge. That's primarily because the 3G standards are closely related to the CDMA technology it has mastered. Still, TI has a broader customer base, a tight relationship with market-leader Nokia, and a proven ability to integrate phone chips with other capabilities. Analysts figure the two giants will end up dominating the 3G market, with Qualcomm having a somewhat greater share. "It's going to be tough for other companies to stay with those two," says Gartner Inc. analyst Stan Bruederle.

However that battle plays out, Templeton believes other digital consumer devices could be as important for TI's growth as cell phones. One promising product: digital light-processing (DLP) chips. Designed for high-end digital projectors used in movie theaters, TI now is making them the hottest thing in big-screen TVs. Their low cost allows manufacturers to undercut the cost of plasma and liquid-crystal display TVs significantly. According to researcher iSuppli, sales of TVs that use DLPs will more than triple this year to 748,000, and hit 2.3 million in 2007. Meantime, as Templeton points out, the technology Intel is betting on in TVs, liquid-crystal-on-silicon (LCOS), is still on the drawing board.

Investors likely will continue to worry about the prospects for TI and the rest of the chip industry. Still, Templeton has the company positioned smack in the middle of some of the most promising trends in tech. His wager on convergence looks like a pretty good bet. ■

–By Andrew Park in Dallas

BusinessWeek online For a Q&A with Texas Instruments CEO Richard Templeton, go to www.businessweek.com/magazine/extra.htm

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COMMENTARY

BY ROBERT D. HOF

'Please God, Just One More Bubble'

Giddiness is creeping back into the tech sector. It's time for a reality check

CHASTENED BY THE tech bust, venture capitalists and entrepreneurs have spent the last couple of years taking startups back to basics. No longer could they expect to turn an idea scribbled on a napkin into an instant company and cash out in a couple of years. To get funding and go public, companies had to have solid technology and business models, experienced management, reasonable valuations—and, above all, profits. This reassuring regime made it easy to laugh at a bumper sticker sighted around the Valley last year: "Please God, just one more bubble."

Now, it looks less like a joke than a warning. Too many tech investors, from Wall Street to Sand Hill Road, seem to be ignoring why they crashed after the 1990s hit a dead end. Venture capitalists are pouring money into look-alike startups in nascent sectors such as social networking. Even after a recent swoon, stocks of some dot-coms, such as eBay Inc., look pricey. And not only are more money-losing companies going public, initial valuations can be distinctly frothy. Google Inc.'s imminent offering, for instance, could value the search engine phenom at $36 billion. Says Bill Burnham, managing partner of the VC firm Softbank Capital Partners: "Some people expect the good old days will be back and they can party like it's 1999."

Understandably, people in tech are eager to get in gear after idling for so long by the curb. There's also good reason for optimism: Tech spending is expected to rise at least 6% this year, the most since 2000. Plus, periodic spasms of excess can spark true successes, so getting just a little nuts ultimately may be healthy for the tech industry. Notes Reed Hastings, chief ecutive of the online DVD rental service Netflix Inc.: "It's of this stage in the venture cycle that you get the Ciscos a the Microsofts."

Nonetheless, when even some cheerleaders of the last bo are worried that they're falling back into bad old habits, it's ti to take heed. That's especially true at a time when moment in some tech sectors could be slowing. Otherwise, we may more nasty surprises like those that hit Internet companies late July. Just a penny shy of analysts' estimates, for instan Amazon.com Inc. saw its stock plunge 13% on July 23. "The thusiasm has gotten ahead of the fundamentals," says Julie F ris, founder of e-mail startup Scalix Corp. So it's worth takin closer look at the danger signals flashing in tech.

Let's start with the VCs. At least $50 billion committed to th funds has yet to be invested, even as more money is starting pour into new funds. All that money is burning a hole in vestors' pockets. That's why a few areas, such as nanotechnolo antispam softwa and social netwo ing sites, are sta ing to smoke—w rying even so VCs. Says Vin Khosla, general partner with the firm Kleiner Perkins Caufield & By in Menlo Park, Calif.: "Valuations a going higher, and some are starti to get irrational."

Nowhere is that more appare than in the 200 or so social networ ing sites, such as Friendster, Tri Networks, and LinkedIn, which he people find dates, friends, and jo You know something is askew wh you see marginal sites such as HA STERster, for fans of the rodent, ar Swappster.com, a swinger exchang Such sites have logged little revenu and it's unclear how they'll turn profit, but that hasn't stopped V from investing $100 million or mo in at least a dozen of them. "Soci networking is probably the mo overinvested venture-capital area Kleiner general partner L. Joh Doerr said earlier this year. H should know: His firm has put mo than $10 million into two companie

IPO AHEAD Linspire CEO Michael Robertson

Warning Signs

Despite the boom and bust, some people in tech are getting carried away again as the industry continues its recovery.

VENTURE CAPITAL Some emerging tech sectors, from nanotech to social networking, are starting to overheat. The nearly 200 social networking sites on the Web show little evidence of profitable business models.

INITIAL PUBLIC OFFERINGS Big first-day pops in some IPOs have returned, even as 44% of companies going public so far this year are losing money, up from 30% last year.

STOCK MARKET Although the tech-heavy NASDAQ is down 6% so far this year, pockets of froth are appearing. Amazon.com's stock is up 26% so far this year.

Data: Renaissance Capital and *BusinessWeek*

ible Path Corp. and Friendster Inc. latter was valued at more than $50 lion at the last funding round late last r, though it had virtually no revenues. And even with the tech-heavy NASQ exchange down 6% this year, the ectations of public investors may l be too high. At the recent Innova- Summit held by the online tech net- rk AlwaysOn at Stanford University, VCs and two investment bankers sat a panel entitled "Is the Bubble k?" Asked if they think the public rkets are overvalued, all four raised ir hands. "People don't understand business models of the companies re taking to market," conceded pan- t Janice Roberts, a general partner h the VC firm Mayfield.

melling Blood

DEED, THE RISE IN shaky initial pub- offerings may be the most worrisome icator that not all investors have med their lesson. Some 44% of the npanies going public so far this year re losing money, compared with only % last year, according to the invest- nt bank Renaissance Capital. "They've vered the bar," says Renaissance ana- t Paul Bard. Why? "The VCs are shing their companies to go out," says Graham, CEO of networking startup ribit Networks Inc., which has held going public for now. "Bankers are sharks smelling blood in the water." Investors are starting to question the h to go public. One high-profile IPO nanotechnology leader Nanosys Inc. s withdrawn on Aug. 4 thanks to lverse market conditions." Yet spec- tive issues remain on the docket. San ego-based operating software firm nspire Inc., for instance, announced in ril plans for an IPO despite losing 6 million on just $1 million in first- arter sales. Then there's Google. De- te its undeniable success and prof- bility, its valuation looks excessive. At 6 billion, it would be worth more an Ford Motor, Nike, or Caterpillar— d almost as much as Yahoo! Inc., hich has much greater experience d diversity. And the Risk Factors sec- n in Google's prospectus runs a bog- ng 12,500 words.

Despite all those warning signs, it's rd to imagine people will get as wild d crazy as they did in the late 1990s. ey had better not. With the devasta- n of the last bust still working its way t of the market, it's no time for folks tech to blow it again. ■

The Race to Stop A Sight Stealer

No magic bullet yet, but new drugs to fight age-related macular degeneration are near

ONE DAY LAST SUMMER, Susan Bosko was trying in vain to wipe little black spots off her white kitchen table when she came to a chilling realization: The spots weren't on the table. She knew immediately that the distortion was caused by age-related macular degeneration (AMD), which had already destroyed her vision in one eye. The disease has since forced Bosko to give up driving, reading, and traveling with her husband. Simple tasks like navigating the steps of the subway near her home in Brooklyn are now "a struggle," says Bosko, 77, whose husband also suffers from AMD. "Our lives have been turned around," she says.

The darkness engulfing Bosko and her husband is all too common. AMD is the leading cause of blindness in people over age 50. The disease attacks the macula—an area of the retina at the back of the eye that houses light-sensing cells. As these cells die off, central vision deteriorates. Doctors anticipate an epidemic of AMD as baby boomers reach their 60s. The National Eye Institute estimates that the number of Americans with moderate to severe AMD will more than double to 17 million by 2020. There's no cure. And the one treatment cleared by the Food & Drug Administration, from Swiss drugmaker Novartis, is only approved for a subset of patients.

A growing number of biotech and pharmaceutical companies are focusing on this desperate group of patients. And on Aug. 27, an FDA advisory panel will review the first new treatment for AMD in four years. Developed by Eyetech Pharmaceuticals Inc. of New York, the drug, Macugen, could hit the market as soon as 2005. Swiss eye-care giant Alcon Inc. and biotech leader Genentech Inc. in South San Francisco are close behind with competing treatments. And several smaller biotechs are already working on the next generation of drugs.

TARGETING A CAUSE

NONE OF THE EARLY treatments is a magic bullet. For that reason, it may be several years before sales of all AMD drugs combined exceed $1 billion, according to industry analysts. Nevertheless, eye doctors are encouraged that so many companies are targeting the illness—and that they are bringing new insights into the degenerative process to bear. For the first time, "we're trying to treat the root cause of this disease," says Dr. Steve Schwartz, associate professor of ophthalmology at the University of California

Aging boomers have given Big Pharma an incentive

BLIND SPOTS Leaky blood vessels under the retina cause the severe form of AMD that leaves victims blind

at Los Angeles, who has advised both Eyetech and Genentech.

The agent of destruction in AMD is the proliferation of abnormal blood vessels under the retina. These can leak, causing fluid to build up under the macula, which leads to the descent into blurriness and blindness. It's not surprising, therefore, that two of the drugs that are closest to reaching the market target a protein—called VEGF, for vascular endothelial growth factor—that promotes the growth of blood vessels.

Eyetech's Macugen attacks VEGF by means of a new type of therapeutic molecule called an aptamer. A short strand of nucleic acid, it binds to the specific subtype of VEGF that scientists believe is most directly responsible for abnormal blood vessel growth. Eyetech's delivery method, however, is less than ideal. Ophthalmologists must inject Macugen into patients' eyes once every six weeks. With local anesthesia, the procedure is painless. But the shots can cause infections, cataracts, or worse, retinal detachments and blindness. "It's not the drug that presents a high risk of side effects, but rather the mode of administration," admits Dr. Anthony P. Adamis, chief scientific officer for Eyetech.

Perhaps a bigger hurdle is the response rate among patients in Eyetech's clinical trials. In an initial, small trial published in May, 2003, a respectable 26% of patients regained some vision. But in a much larger trial reported later that year, Macugen restored sight in only 6% of patients.

On the other hand, the drug did slow vision loss to some extent: Only 30% of patients in the large trial lost the ability to read three or more lines on a standard eye chart over 13 months—far less deterioration than patients in the control group had experienced. That response rate is about the same as the rate Novartis achieved in trials for its drug, Visudyne. Some experts believe the FDA's panel of advisers is likely to welcome Eyetech's drug because it offers a second viable treatment option.

HURDLES AND HEADWAY

AS EYETECH RACES to muster the necessary data, another biotech giant is stalking the same prey. That rival is Genentech, the company that pioneered the first successful VEGF-blocking drug. Last year, Genentech proved that its weapon, Avastin, could slow or stop the rampant development of blood vessels that tumors require in order to grow. Launched in the spring, Avastin can extend life by as much as five months for some late-stage colon cancer patients. The drug pulled in $133 million in sales in the quarter ended in June, and now Genentech is testing a variation of it, called Lucentis, in AMD patients. But despite its experience with VEGF blockers, Genentech faces some of the same hurdles that Eyetech confronts. Lucentis is also administered via a needle, and so far, it requires even more frequent injections.

Alcon has a very different drug in late-stage clinical trials, called Retaane. It targets enzymes that weaken blood-vessel walls in the retina and a abnormal vessels to gr One big selling point r out of the gate: It needs to be administere patients every six mon What's more, the safety sues surrounding a VEGF drugs could giv boost to Retaane, whic squirted into the disea area without puncturing the eye. "Av ing the needle is a major plus," says Ja S. Slakter, a surgeon and director at Manhattan Eye, Ear & Throat Hosp who has participated in trials for Al Genentech, and Eyetech.

One hope is that the new drugs get combined in "cocktails"

While Alcon and its rivals are prep ing to duke it out, several biotechs working on entirely new methods for tacking AMD. One promising approac called RNA interference. Scientists pur ing RNAi hope to activate the "off" swi in the genes that produce either VEGF the receptor protein that allows it to do destructive work. The technique invol injecting small double strands of RN the molecules that translate DNA i proteins. The snippets bind to the m senger RNA and break it down.

As a result, the proteins that Macug and the other new drugs are designed destroy would never get produced in first place. "We're turning off the spi instead of mopping up the floor," s John Maraganore, CEO of Alnylam Ph maceuticals Inc. in Cambridge, Ma one of several biotechs developing RN treatments for AMD.

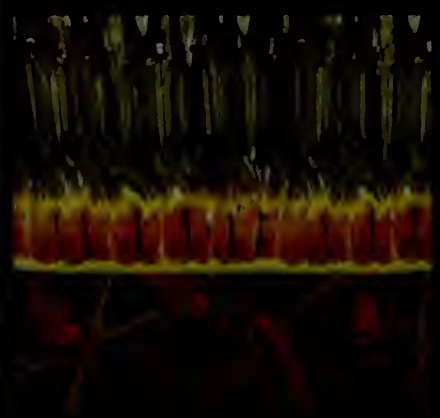
Maraganore and others hope su gene-based approaches will help patie with advanced AMD regain their sight and prevent those in the early stages the disease from losing any vision at Naturally, that's also the goal for Eyete Genentech, and Alcon, although none their near-term treatments appears achieve these ambitious goals. The m potent weapons against AMD could pro to be combinations of two or more n drugs, including Visudyne. But such t als will have to wait until the FDA give green light to the new treatments.

Because drug "cocktails" have be such an effective strategy in diseas such as HIV/AIDS, drug industry an lysts are eager to see the multidrug tri begin in earnest. "It's not a zero su game," says Jay Markowitz, a biote analyst for T. Rowe Price. After so ma years struggling in the darkness, AM patients and the physicians who tre them will welcome every ray of light.

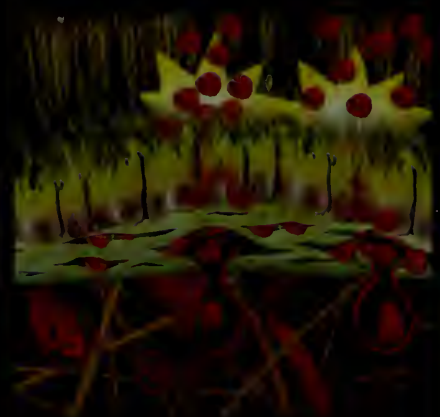
–By Arlene Weintraub in Los Angel

Descent into Blindness

Macular degeneration, the leading cause of sight loss in people over age 50, strikes the part of the eye responsible for central vision



NORMAL EYE Blood vessels under the retina nourish the light-sensing cells that are crucial to vision.



DISEASED EYE Abnormal blood vessels burst through the retina's protective membrane.

Data: Novartis Pharmaceuticals Corp.

OMMENTARY

Y RONALD GROVER

A War That Hollywood Can't Afford

s DVD sales slow, any delay of next-generation must-haves will cost the studios

HOT AGAIN 1962's *Lawrence of Arabia*

FOR HOLLYWOOD EXECUTIVES, the hottest movie in recent months has been the sprawling 1962 epic *Lawrence of Arabia*. No, Sony Corp.'s Columbia Pictures asn't rereleased the flick. Instead, it's be- ıg shown in private screening rooms round town by Sony executives in a furi- us behind-the-scenes battle over who ill control the industry's Next Big Thing: gh-definition DVDs. Like previous format wars, such as the ter clash that pitted VHS against Betamax videotape stan- rds in the early 1980s, this one promises to have even more tion than David Lean's Oscar-winning film.

On one side, Sony, along with 12 leading companies in the mputer and consumer-electronics industries, is pushing a for- at called Blu-ray. It has the capacity to hold as much as six nes the number of TV shows and movies that a current DVD lds. Blu-ray also promises spellbinding clarity that prompted me studio execs to swear they saw insignias on the horses in a noramic shot in *Lawrence of Arabia*. The competing format, omoted by Toshiba and NEC Corp., has clear pictures, too—and can be made more cheaply by using existing DVD plants. But it s less capacity than Blu-ray. Both offer anti-piracy protection.

The prize for winning this contest is huge. The consortium at triumphs in the standards war will clearly be in a position to n an explosive new category of consumer hardware. What's s obvious is how high the stakes are for Tinseltown. Today, Ds generate as much as 50% of a film's revenues. But that ndfall may soon diminish. By 2008, last year's 44% growth in traditional DVD sales will slow to 7%, figures PricewaterhouseCoopers LLC. And by that time as much as half the country could own high-definition TV sets—on which old DVDs will not have the new clarity. "Folks are going to love the HD picture, and standard DVDs will look pretty tame," says media analyst Harold Vogel. So if the studios don't act quickly to back a unified HD format, there'll be no new revenue stream to replace that big cash cow.

None of this drama is lost on the contenders. The hardware lobbying campaign began late last year when Toshiba enlisted help from software giant Microsoft Corp. to provide it with compression technology to squeeze HD content onto its discs. Microsoft's support helped Toshiba win approval for some of its technology from the DVD Forum, a 200-company group that sets technical specifications. That allowed Toshiba to move forward with tests. Sony, quite uncharacteristically, offered to share its technology. It lined up Panasonic, Philips Electronics, Hewlett-Packard, Dell, and other leading brands, in part, critics say, by offering some a cut of Sony's Blu-ray royalties. Sony execs wouldn't comment, and Microsoft says it remains open to working with the Blu-ray group as well.

So far, Hollywood moguls have chosen to sit on the fence and let the techies fight it out—a self-destructive decision. As the rollout of digital entertainment accelerates and choices for consumers proliferate beyond DVDs, movie studios can ill afford a delay in the expansion of a rich new marketplace—or confuse consumers with two competing formats.

HDTV owners will want high-def DVDs

For Hollywood's sake, history needs to repeat itself. In the early 1990s, when Sony and Toshiba were fighting a similar war over the then-new DVD, it took a member of the Hollywood Establishment, strong-willed Warner Bros. executive Warren Lieberfarb, to push for a compromise that eventually gave Toshiba and Warner the lion's share of royalties. Problem is, consumer electronics and Hollywood have often been fractious industries, holding back progress because of stubbornness and ego. "We can't let that happen again," says Steve Beeks, president of independent studio Lions Gate Entertainment Inc. That's for sure—because in an age of so many entertainment options, winning consumers' loyalty can be as arduous as a camel ride across the desert. ■

PHOTOFEST

GLOBAL WARMING

Consensus is growing among scientists, governments, an business that they must act fast to combat climate change. This ha already sparked efforts to limit CO_2 emissions. Many companie are now preparing for a carbon-constrained world. **BY JOHN CARE**

THE IDEA THAT THE HUMAN SPECIES COULD ALTER SOMETHING as huge and complex as the earth's climate was once the subject of an esoteric scientific debate. But now even attorneys general more used to battling corporate malfeasance are taking up the cause. On July 21, New York Attorney General Eliot Spitzer and lawyers from seven other states sued the nation's largest utility companies, demanding that they reduce emissions of the gases thought to be warming the earth. Warns Spitzer: "Global warming threatens our health, our economy, our natural resources, and our children's future. It is clear we must act."

The maneuvers of eight mostly Democratic AGs could be seen as a political attack. But their suit is only one tiny trumpet note in a growing bipartisan call to arms. "The facts are there," says Senator John McCain (R-Ariz.). "We have to educate our fellow citizens about climate change and the danger it poses to the world." In January, the European Union will impose mandatory caps on carbon dioxide and other gases that act like a greenhouse over the earth, and will begin a market-based system for buying and selling the right to emit carbon. By the end of the year, Russia may ratify the Kyoto Protocol, which makes CO_2 reductions mandatory among the 124 countries that have already accepted the accord. Some countries are leaping even further ahead. Britain has vowed to slash emissions by 60% by 2050. Climate change is a greater threat to the world than terrorism, argues Sir David King, chief science adviser to Prime Minister Tony Blair: "Delaying action for a decade, or even just years, is not a serious option."

There are naysayers. The Bush Administration flatly rejects Kyoto and mandatory curbs, arguing that such steps will cripple the economy. Better to develop new low-carbon techno gies to solve problems if and when they appear, says Ener Secretary Spencer Abraham. And a small group of scientists s argues there is no danger. "We know how much the planet going to warm," says the Cato Institute's Patrick J. Michaels. ' is a small amount, and we can't do anything about it."

But the growing consensus among scientists and gover ments is that we can—and must—do something. Researche under the auspices of the National Academy of Sciences and t Intergovernmental Panel on Climate Change (IPCC) have po dered the evidence and concluded that the earth is warmin that humans are probably the cause, and that the threat is re enough to warrant an immediate response. "There is no dispu that the temperature will rise. It will," says Donald Kennec editor-in-chief of *Science*. "The disagreement is how much." I deed, "there is a real potential for sudden and perhaps cat strophic change," says Eileen Claussen, president of the Pe Center on Global Climate Change: "The fact that we are u certain may actually be a reason to act sooner rather than later

Plus, taking action brings a host of ancillary benefits. The ma way to cut greenhouse-gas emissions is simply to burn less fo sil fuel. Making cars and factories more energy-efficient and u ing alternative sources would make America less dependent c the Persian Gulf and sources of other imported oil. It would mean less pollution. And many companies that have cut emissions have discovered, often to their surprise, that it saves money and

SNOWMELT
Rapid runoff from the Greenland Ice Sheet in summer

spurs development of innovative technologies. "It's impossible to find a company that has acted and has not found benefits," says Michael Northrop, co-creator of the Climate Group, a coalition of companies and governments set up to share such success stories.

That's why there has been a rush to fill the leadership vacuum left by Washington. "States have stepped up to fill this policy void, as much out of economic self-interest as fear of devastating climate changes," says Kenneth A. Colburn, executive director of Northeast States for Coordinated Air Use Management. Warning of flooded coasts and crippled industries, Massachusetts unveiled a plan in May to cut emissions by 10% by 2020. In June, California proposed 30% cuts in car emissions by 2015. Many other states are weighing similar actions.

Curbing Carbon

REMARKABLY, BUSINESS is far ahead of Congress and the White House. Some CEOs are already calling for once-unthinkable steps. "We accept that the science on global warming is overwhelming," says John W. Rowe, chairman and CEO of Exelon Corp. "There should be mandatory carbon constraints."

Exelon, of course, would likely benefit as the nation's largest operator of commercial nuclear power plants. But many other companies also are planning for that future. American Electric Power Co. once fought the idea of combating climate change. But in the late 1990s, then-CEO E. Linn Draper Jr. pushed for a strategy shift at the No. 1 coal-burning utility—preparing for limits instead of denying that global warming existed. It was a tough sell to management. Limits on carbon emissions threaten the whole idea of burning coal. But Draper prevailed. Why? "We felt it was inevitable that we were going to live in a carbon-constrained world," says Dale E. Heydlauff, AEP's senior vice-president for environmental affairs.

Now, AEP is trying to accumulate credits for cutting CO_2. It's investing in renewable energy projects in Chile, retrofitting school buildings in Bulgaria for greater efficiency, and exploring ways to burn coal more cleanly. Scores of other companies are also taking action—and seeing big benefits. DuPont has cut its greenhouse-gas emissions by 65% since 1990, saving hundreds of millions of dollars in the process. Alcoa Inc. is aiming at a 25% cut by 2010. General Electric Co. is anticipating growing markets for its wind power division and for more energy-efficient appliances. And General Motors Corp. is spending millions to develop hydrogen-powered cars that don't emit CO_2. A low-carbon economy "could really change our industry," says Fred Sciance, manager of GM's global climate issues team. As Exelon knows, the need for carbon-free power could even mean a boost for advanced nuclear reactors, which produce electricity without any greenhouse-gas emissions.

Global warming could change other industries, too. Even if the world manages to make big cuts in emissions soon, the earth will still warm several more degrees in coming decades, most climate scientists believe. That could slash agricultural yields, raise sea levels, and bring more extreme weather.

For businesses, this presents threats—and opportunities. Insurers may face more floods, storms, and other disasters. Farmers must adjust crops to changing climates. Companies that pioneer low-emission cars, clean coal-burning technology, and hardier crop plants—or find cheap ways to slash emissions—will take over from those that can't move as fast. "There is no silver bullet," says Chris Mottershead, distinguished adviser at BP PLC: "There is a suite of technologies that are required, and we need to unleash the talent inside business" to develop them.

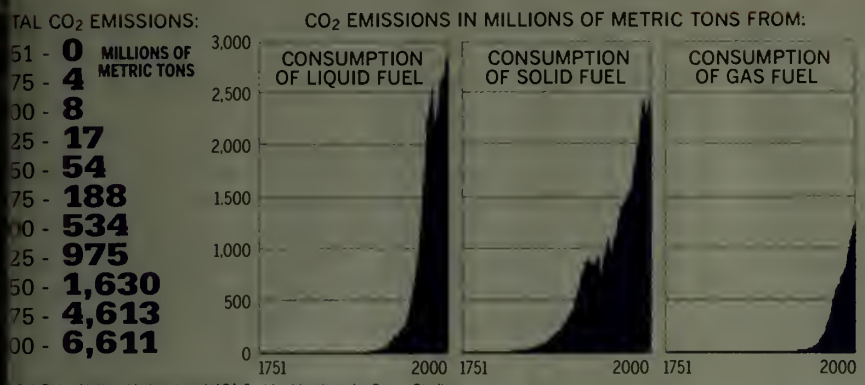
Are we ready for this carbon-constrained, warming world? In

MANY SCIENTISTS AGREE

...AND THE EFFECTS ON

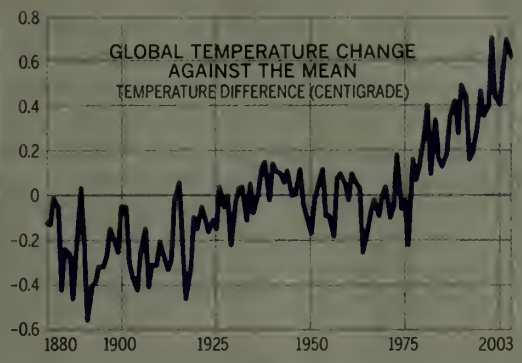
BASICS OF GLOBAL WARMING...

Emissions of CO_2 have been rising steadily...



Oak Ridge National Laboratory, NASA Goddard Institute for Space Studies

...contributing to rising temperatures



ANET COULD BE DIRE

Bangladesh has had its worst floods in years

1 FLOODING Seawaters could rise almost a meter in this century, and continue going up. Some coastal regions already see seasonal flooding, and the situation would get worse as water levels rise.

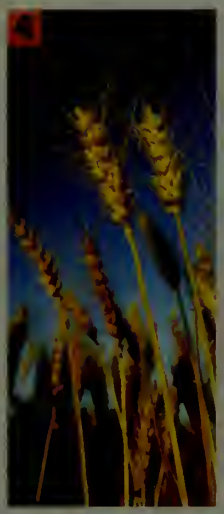
2 OCEAN DISRUPTIONS Coral reefs are under pressure from changes in water level and temperature. As more carbon goes into the sea, plankton could suffer, and that would affect species higher up the food chain.

3 SHIFTING STORM PATTERNS There are no data to show an increase in violent storms right now, but many scientists believe warming will bring more violent and unpredictable climate events.

4 REDUCED FARM OUTPUT In certain regions, each degree rise in the surface temperature brings a further drop in crop yields.

5 ANIMAL EXTINCTIONS Some species are already moving to cooler regions—and some aren't making it. Global warming may not yet be a factor, but it will almost certainly take its toll on species.

6 DROUGHTS In past periods of climate change, whole sections of Africa turned to desert. In extreme scenarios, areas that are currently fertile could become barren and dry.



An endangered lizard in Australia

(CLOCKWISE FROM TOP) EDDIE HIRONAKA/GETTY IMAGES; KEVIN MORRIS/STONE/GETTY IMAGES; MICHAEL & PATRICIA FOGDEN/MINDEN PICTURES; GARY BRAASCH; REED TIMMER & JIM BISHOP/JIM REED PHOTOGRAPHY/PHOTO RESEARCHERS; PETER SCOONES/SCIENCE PHOTO LIBRARY/PHOTO RESEARCHERS INC; RAFIQUR RAHMAN/REUTERS

some ways, yes. "There is a case to be made for cautious optimism, that we are making small steps," says BP's Mottershead.

Indeed, there is surprising consensus about the policies needed to spur innovation and fight global warming. The basic idea: mandatory reductions or taxes on carbon emissions, combined with a worldwide emissions-trading program. Here's how it could work: Imagine that each company in a particular sector is required to cut emissions by 20%. The company could meet the target on its own by becoming more energy efficient or by switching from fossil fuels to alternatives. But it could also simply buy the needed reductions on the open market from others who have already cut emissions more than required, and who thus have excess emissions to sell (table, page 66). Under a sophisticated worldwide carbon-trading system, governments and companies could also get sellable credits for planting trees to soak up carbon or for investing in, say, energy efficient and low-carbon technologies in the developing world. As a result, there is a powerful incentive for everyone to find the lowest-cost and most effective cuts—and to move to lower-carbon technologies.

A key element is long-term predictability. If the world sets goals for the next 50 years, as Britain has done, and then implements the curbs or taxes needed to reach them, companies will figure out solutions. "Give us a date, tell us how much we need to cut, give us the flexibility to meet the goals, and we'll get it done," says Wayne H. Brunetti, CEO and chairman of Xcel Energy Inc., the nation's fourth-largest electricity and gas utility.

The Challenge

SUCH CLEAR POLICY SIGNALS should bring major efficiency gains. Even 30% to 40% reductions in emissions by 2020 are possible, says Northrop. After that, he suggests, shifts to new energy technologies "can get the other 35% to 40% that we need to get to the low-carbon emission future."

The good news is that the world sees the threat and has begun to respond. The bad news is the magnitude of the task. Rising CO_2 levels in the atmosphere can't be slowed or reduced if only a few countries—or even all the industrialized nation take action. The world must also figure out a way to per growth in China, India, and other developing nations wh lowering consumption of coal, gasoline, and other fossil fu "It's hard to think of a public policy issue that is harder th this one," says economist Jeffrey D. Sachs, director of Colum University's Earth Institute.

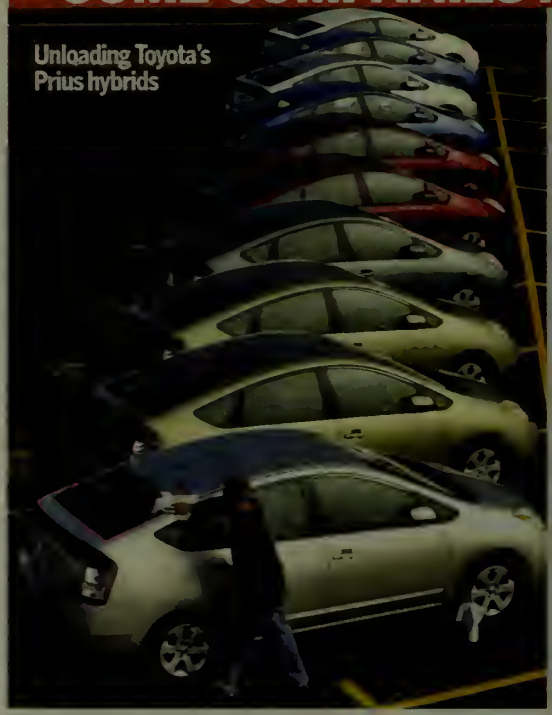
Developing countries are responsible for just over one-th of the world's greenhouse-gas emissions. But they emit l than one-fifth as much per person as do the industrialized n tions. That will increase as their citizens buy more cars and co sume more energy. By 2100, these countries will emit two three times as much as the developed world, experts predict

The Bush Administration and Congress have seized up this issue as one reason for rejecting the Kyoto Protocol, whi doesn't include the developing world. But international neg tiators are beginning to talk about a plan that would go beyo Kyoto. The first step: showing that the industrialized world serious about leading the way. That's one of the motivations b hind Britain's vow to slash emissions by 60%, for examp Britain knows it can't solve this global problem by itself. B committing to reducing CO_2 "is the right thing to do," say British Energy Minister Stephen Timms. It will also keep th country from becoming dependent on foreign oil when it North Sea oil fields start to run dry in a few years.

The next step is to help the developing world adopt new tech nologies. China and other nations could avoid the West's era o gas-guzzlers and dirty power plants by jumping to highly effi cient clean coal plants and hybrid or advanced diesel cars What's needed, experts say, are incentives to stimulate compa nies to make investments in advanced technology in developing countries. Once an international carbon-trading system is put in place, suggests Elliot Diringer, director of international strate gies at the Pew Center on Global Climate Change, "we can re duce our own costs in the U.S. by allowing our companies to g the benefit of low-cost emissions abroad."

Still, even if the developing world comes on board, staggering

SOME COMPANIES ARE ALREADY MAKING CHANGES...



Unloading Toyota's Prius hybrids

AMERICAN ELECTRIC POWER Is investing in renewable energy projects in Chile, exploring ways to burn coal more cleanly, and testing methods to sequester carbon.

FLORIDA POWER & LIGHT Invested in 42 wind facilities and energy efficiency, eliminating the need to build 10 power plants.

GENERAL ELECTRIC Purchased Enron's wind business and a solar energy company; doing research on earth-friendly hydrogen and lower-emission jet engines and locomotives.

GENERAL MOTORS Developing hydrogen-powered cars that don't emit CO_2.

INTEL Researching chemicals, for use on chip production lines, that don't contribute to greenhouse effect; developing ultra energy-efficient chips.

TOYOTA The world leader in hybrid gas-electric cars that deliver superior fuel efficiency.

'he past few decades are the warmest since people egan keeping records—changing the planet's face

uctions in emissions are needed. Consider the math. For the t 450,000 years, the amount of carbon dioxide in the atmos- ere has stayed below 290 parts per million (ppm). Now, we are wing out more than 7 gigatons of carbon a year and large ounts of other greenhouse gases such as methane. As a result, CO_2 levels in the air have climbed past 370 ppm. With no ac- n, those levels could jump to 800 to 1,000 ppm by the end of century. "We are already in dire straits," warns Columbia iversity geophysicist Klaus S. Lackner (chart, page 63).

he Science

N SERIOUS CONSEQUENCES be prevented? The British vernment, many scientists, and some executives are urging all-out effort to keep the earth from warming more than two grees Celsius. "The consequences of changes above two de- ees are so dreadful that we need to avoid it," says BP's Mot- rshead. To hit that target, scientists calculate that CO_2 con- ntrations in the atmosphere must be kept from reaching 550 m—twice the preindustrial level. Getting there may require tting the world's per capita emissions in half by 2100.

Of course, there is great uncertainty surrounding the science global warming. No one can really know the size and conse- ences of climate change. "Without a doubt, it will be a very ferent world—a much warmer world," says David S. Battisti, mospheric scientist at the University of Washington. But how uch warmer? Which regions will be better or worse off? Will ere be more floods and droughts? There's even a chance of rprises beyond the scary predictions of some computer mod- s. "What's worrisome are the unknown unknowns," says niel P. Schrag, director of the Laboratory for Geochemical eanography at Harvard University. "We are performing an experiment that hasn't been done in millions of years, and no one knows exactly what's going to happen."

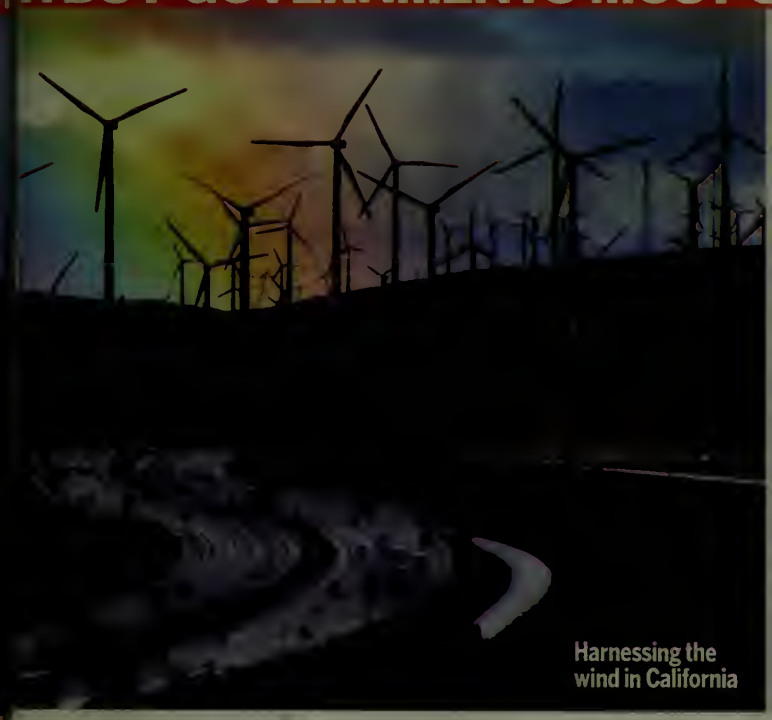
What scientists do know is that carbon dioxide and a number of other gases act like the roof of a greenhouse. Energy from the sun passes through easily. Some of the warmth that normally would be radiated back out to space is trapped, however, warming the planet. With no greenhouse gases at all in the atmosphere, we would freeze. The earth's average temperature would be a cold –17C, not the relatively balmy 14C it is today.

But the atmosphere is fiendishly complicated. If an increase in greenhouse gases also makes the sky cloudier, the added clouds may cool the surface enough to offset warming from CO_2. Tiny particles from pollution also exert warming or cooling effects, depending on where they are in the atmosphere. Naysayers argue that it's just too soon to tell if greenhouse gases will significantly change the climate.

Yet the climate is changing. In the past 100 years, global temperatures are up 0.6 degrees Celsius. The past few decades are the warmest since people began keeping temperature records—altering the face of the planet. For instance, the Qori Kalis glacier in Peru is shrinking at a rate of 200 meters per year, 40 times as fast as in 1978. It's just one of hundreds of glaciers that are vanishing. Ice is disappearing from the Arctic Ocean and Greenland. More than a hundred species of animals have been spotted moving to cooler regions, and spring starts sooner for more than 200 others. "It's increasingly clear that even the modest warming today is having large effects on ecosystems," says ecologist Christopher B. Field of the Carnegie Institution. "The most compelling impact is the 10% decreasing yield of corn in the Midwest per degree [of warming.]"

More worrisome, scientists have learned from the past that seemingly small perturbations can cause the climate to swing

...BUT GOVERNMENTS MUST SHOW LEADERSHIP



Harnessing the wind in California

THE U.S. is funding research in new energy technologies, while calling for voluntary reductions in carbon emissions. But both parties have failed to make global warming a top policy priority. Some states are now calling for mandatory cuts and some are requiring that electricity be generated from alternative sources.

THE EUROPEAN UNION will begin a carbon-cutting and trading system in January. The EU has also made a deal with auto makers to cut vehicle emissions. In addition, Britain has been particularly aggressive, setting a long-term target of 60% reduction in carbon emissions.

CHINA is struggling to devise a road map that will allow for continued, rapid growth without huge rises in pollution and greenhouse-gas emissions.

JAPAN hosted and signed the Kyoto accord on emissions reductions in 1997. It hopes to meet its commitments through conservation efforts and increased use of nuclear power.

rapidly and dramatically. Data from ice cores taken from Greenland and elsewhere reveal that parts of the planet cooled by 10 degrees Celsius in just a few decades about 12,700 years ago. Five thousand years ago, the Sahara region of Africa was transformed from a verdant lake-studded landscape like Minnesota's to barren desert in just a few hundred years. The initial push—a change in the earth's orbit—was small and very gradual, says geochemist Peter B. deMenocal of Columbia University's Lamont-Doherty Earth Observatory. "But the climate response was very abrupt—like flipping a switch."

The earth's history is full of such abrupt climate changes. Now many scientists fear that the current buildup of greenhouse gases could also flip a global switch. "To take a chance and say these abrupt changes won't occur in the future is sheer madness," says Wallace S. Broecker, earth scientist at Lamont-Doherty. "That's why it is absolutely foolhardy to let CO_2 go up to 600 or 800 ppm."

Indeed, Broecker has helped pinpoint one switch involving ocean currents that circulate heat and cold (table, page 68). If this so-called conveyor shuts down, the Gulf Stream stops bringing heat to Europe and the U.S. Northeast. This is not speculation. It has happened in the past, most recently 8,200 years ago.

Can it happen again? Maybe. A recent Pentagon report tells of a "plausible . . . though not the most likely" scenario, in which the conveyor shuts off. "Such abrupt climate change . . . c potentially destabilize the geopolitical environment, leadin skirmishes, battles, and even war," it warns.

There are already worrisome signs. The global convey driven by cold, salty water in the Arctic, which sinks to bottom and flows south. If the water isn't salty enough—t heavy enough—to sink, the conveyor shuts down. N scientists are discovering that Arctic and North Atlantic ters are becoming fresher because of increased precipita and melting. "Over the past four decades, the subpolar N Atlantic has become dramatically less salty, while the trop oceans have become saltier," observed William B. Curry of Woods Hole Oceanographic Institutio recent congressional testimony. "Th salinity changes are unprecedented in relatively short history of the scienc oceanography."

If the global switch does flip, an Ice won't descend upon Europe, scien now believe. But that doesn't mean consequences won't be severe. The sol ing lesson from the past is that the clim is a temperamental beast. And now, w the atmosphere filling with greenho gases, "the future may have big surpr in store," says Harvard's Schrag.

In some scenarios, the ice on Gre land eventually melts, causing sea le to rise 18 feet. Melt just the West Antar ice sheet as well, and sea levels jump other 18 feet. Currently shrinking glac may mean threats to water supplies farmers and cities. Meanwhile, hig temperatures can cut crop yields, inh rice germination, and devastate biolo cally vital ecosystems like coral reefs paper in the July 16 issue of *Science* s gests that increasing CO_2 levels in ocean could affect the growth of mar life, with consequences for the ocea food chain.

HOW TO TRADE CARBON CREDITS

One good way to reduce emissions of CO_2 is to set limits—and then let companies and countries buy and sell the right to spew out the gas to meet those limits. Here's how such a scheme would work:

THE CUTS

Countries would set a mandatory target for reducing emissions of greenhouse gases by, say, 20% by 2020. Then governments would allocate those cuts among various industries, such as utilities, transportation, etc. Without specifying any technological solutions, governments would mandate, for instance, that cars must get higher mileage, or utilities emit less carbon.

THE OPTIONS

Individual companies could meet the targets governments set in several ways. They could make cuts themselves, or they could buy rights to emit from others that have made more cuts than required. If the companies themselves cut more than they need to, they could sell that extra, just like any other commodity. They could also earn credits for planting trees that soak up carbon or for investing in low-emission technology in developing countries such as China. Those credits too could be bought and sold.

THE BENEFITS

In addition to meeting reduction targets and lessening the threat of global warming, such a worldwide market-based trading system would help protect forests because the land might prove more valuable for capturing carbon than for ranching. It would also reduce world dependence on oil, spur development of energy-efficient technologies and energy alternatives, and help get developing nations engaged in carbon-reduction efforts.

Prevent or Adapt?

PERHAPS THE CENTRAL debate in glo warming now is not about the underlyi science, but whether it's better—a cheaper—to take steps to prepare for prevent climate change now, or to sim roll with the punches if and when it ha pens. Opponents of greenhouse-gas cu say we should be able to adapt to a warm world or even cool it back down. "I'm convinced there will be e gineering schemes that will allow our children's children to ha whatever climate they want," says Robert C. Balling Jr., a clim tologist at Arizona State University and coauthor of *The Sata Gases*, which argues that the worries are vastly overblown.

Yes, human beings can adapt, advocates of immediate acti retort. But why run even the small risk of catastrophic chang when important steps can be taken at a modest cost now? British government panel, for instance, concluded that the c of its share of the task of limiting the level of CO_2 to 550 pp would be about 1% of Britain's gross domestic product.

Compare that, says Sir David King, with the cost of a sing

"Hey, it's your money. I'm just trying to save you some of it."

– Mr. Opportunity

Odyssey EX

Opportunity knocks only once a year. And it's gone before you know it. See your Honda dealer while the window of opportunity is still wide open.

The 2004 Honda Clearance

clearance.honda.com

By taking action to thwart global warming, companies may not only cut costs but also spark tech innovation

flood breaking through the barrier in the Thames River—some 30 billion pounds, or 2% of current GDP. "Common sense says that it's time to purchase some low-cost insurance now," says economist Paul R. Portney, president of Resources for the Future.

The Business Response

WHEN CEOs CONTEMPLATE global warming, they see something they dread: uncertainty. There's uncertainty about what regulations they will have to meet and about how much the climate will change—and uncertainty itself poses challenges. Insurance giant Swiss Re sees a threat to its entire industry. The reason: Insurers know how to write policies for every conceivable hazard based on exhaustive study of the past. If floods typically occur in a city every 20 years or so, then it's a good bet the trend will continue into the future. Global warming throws all that historical data out the window. One of the predicted consequences of higher greenhouse-gas levels, for instance, is more variable weather. Even a heat wave like the one that gripped Britain in 1995 led to losses of 1.5 billion pounds, Swiss Re calculates. So an increase in droughts, floods, and other events "could be financially devastating," says Christopher Walker, a Swiss Re greenhouse-gas expert.

That's why Swiss Re has been pressing companies to plan for possible effects of warming. Lenders may require beefed-up flood insurance before issuing mortgages. Chipmakers m find replacements for greenhouse-gas solvents. Utilities nee prepare grids to handle bigger loads and to boost power fi renewable sources. Oil companies need to think about a fut where cars use less gas—or switch to hydrogen.

Swiss Re says the word is getting out, but not fast enough a recent survey, "80% of CEOs said that climate change w potential risk, but only 40% were doing something about says Walker. "That's not good to hear for insurers."

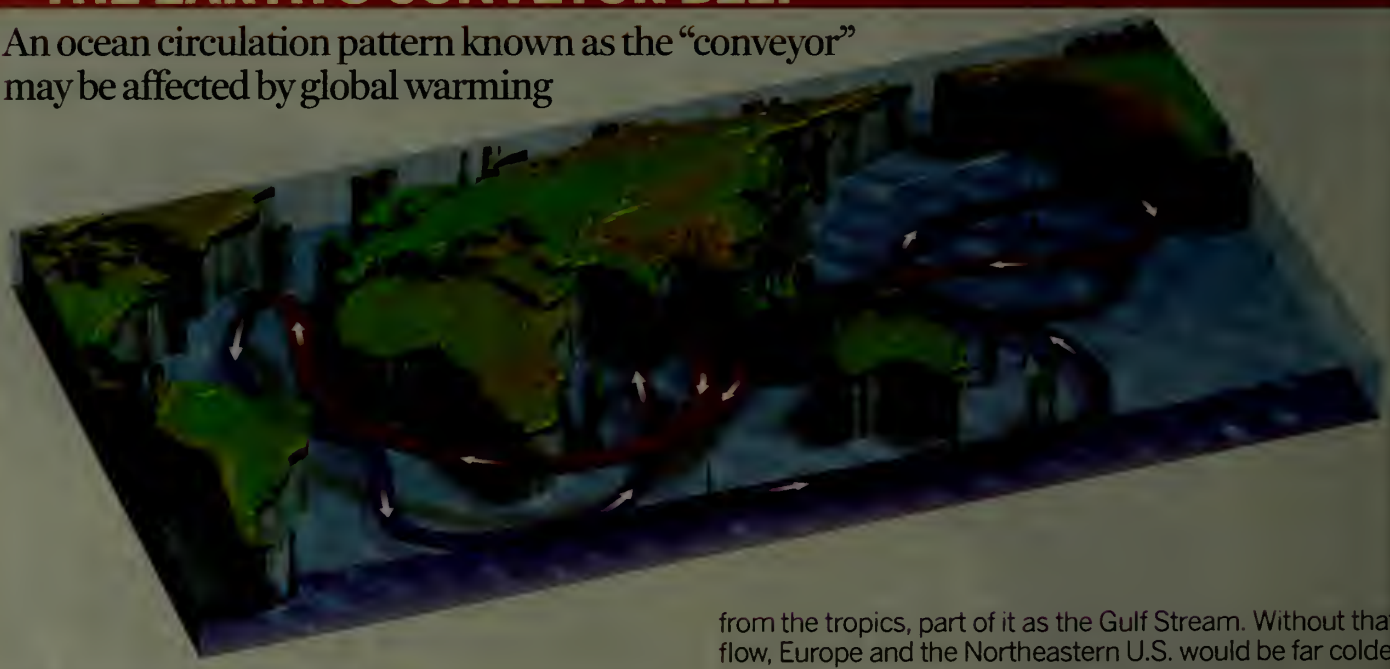
Shareholders are also demanding that companies assess risks of global warming and devise coping strategies. Moreo multinationals have no choice but to plan for emissions cuts cause of the coming EU carbon limits and possible restricti on other greenhouse gases.

Intel Corp., for example, is worried the EU could ban the of perfluorocarbons (PFC), chemicals used in chipmaking t are potent greenhouse gases. "We are looking for substitu but don't have any yet," says Intel's Stephen Harper. "We cided to craft a worldwide agreement to reduce PFC emissi 10% by 2010—upwards of a 90% reduction per chip. We wa ed to show leadership and not have the EU regulate us."

Utilities face the greatest threat since the bulk of the po er they generate comes from climate-changing fossil fu That's why AEP, Cinergy Corp., and others are probing n technologies that would enable them to capture the carbon coal is burned. That carbon could then be pumped deep in

THE EARTH'S CONVEYOR BELT

An ocean circulation pattern known as the "conveyor" may be affected by global warming



The conveyor moves heat around the earth. It begins in the Arctic and North Atlantic, where water surrounding the ice is cold and salty, hence heavy. This water sinks to the depths of the sea. There, like some unseen river, it flows thousands of miles south, then turns east into the Indian and Pacific oceans. To replace that sinking water, warm water flows up from the tropics, part of it as the Gulf Stream. Without that flow, Europe and the Northeastern U.S. would be far colder. If Arctic ice melts and the North Atlantic waters grow warmer and less salty, they will no longer sink. Suddenly, some scientists speculate, the conveyor might shut down. No more Gulf Stream. No more heat for Europe and the Northeast. This isn't science fiction: The conveyor has shut down in the past with dramatic results.

MIGHTY GLACIERS... RECEDING INTO MIST

Glacier National Park in Montana, an ice cave in Boulder Glacier (left) completely vanished in the course of 56 years

ground to be stored for thousands of years. AEP has ed drill a test well in West Virginia to see if this sort of rbon sequestration" is feasible and safe. And dozens of ities are turning to alternative fuels, from wind to biomass. rida Power & Light Co. now has 42 wind power facilities has pushed energy efficiency, reducing emissions and inating the need to build 10 midsize power plants, ac- ding to Randall R. LaBauve, vice-president for environ- ntal services. "We are seeing more companies committed oluntary or even mandatory reductions," he says. Renew- e energy, not counting hydropower, now produces only 2% he nation's electricity. But some states—along with Presi- tial candidate John Kerry—are proposing that this be in- ased to as high as 20%.

ho Will Lead?

EN WITHOUT MANDATES, scores of companies are taking crete actions. "The science debate goes on, but we know ugh to move now," explains AEP Chief Executive Michael G. rris. It helps that thwarting global warming often brings t savings and business benefits. Indeed, one goal of the new- ormed Climate Group is to share tales of how climate strate- s helped the bottom line. "The ones who have been at it for hile are finding they can do more than is asked for in Kyoto, are achieving all kinds of benefits," says Northrop. BP, for tance, developed its own internal strategy for trading carbon issions. That prompted a companywide search to find the est-cost reductions. Many of the measures were simple, h as identifying and plugging leaks. The overall result: a % reduction in emissions and a $650 million boost to the npany in three years.

Climate-savvy execs are hoping that when carbon limits are posed, they'll get credit for actions already taken. But they're o anticipating big future opportunities. GE bought Enron rp.'s wind business and a solar energy company in addition doing research on hydrogen and lower-emission jet engines locomotives. "We can help our customers meet the chal- ges they are going to face," says Stephen D. Ramsey, GE's ironmental chief. In Arizona, startup Global Research Tech- logies LLC is developing systems that use solvents to grab CO_2 out of the air and isolate it for disposal.

Given this progress, many scientists wonder why the rld—and especially the U.S.—isn't moving faster to reduce chances that global warming will bring nasty surprises. e reason for the inaction is "not the science and not the nomics," says G. Michael Purdy, director of Lamont-Doherty. "Rather it is the lack of public knowledge, the lack of leadership, and the lack of political will."

The Bush Administration counters that taking steps is simply too costly. Imposing limits on the U.S. would throttle growth and put America at a competitive disadvantage around the world. "No nation will mortgage its growth and prosperity to cut greenhouse-gas emissions," says Energy Secretary Abraham. In any case, the White House is not ignoring the issue. It has called for voluntary reductions and it is funding research into new technologies. "If we are successful in developing carbon sequestration and cars that run on hydrogen fuel cells, that solves most of the problem with global warming," Abraham argues. "We may disagree on targets, but no one is going to reach any targets if we don't make these investments."

But most experts believe that mandatory curbs are essential and that they can be implemented at reasonable cost. Indeed, as states jump in with their own patchwork of rules, execs are beginning to say that it may be time to push for uniform national limits. That's what happened in 1990 with pollution rules. Faced with the prospect of dozens of state regulations, companies helped push for federal Clean Air Act amendments that reduced sulfur dioxide emissions through a market-based trading system. The law was a huge success. "We reduced emissions ahead of schedule and at lower cost," says Xcel Energy CEO Brunetti. "It's a great example of what can be done."

The same sort of trading scheme would bring similarly inexpensive greenhouse-gas reductions, many economists, politicians, and execs believe. The EU plan puts a cap on emissions for each country and allows emitters to buy and sell permits to release certain amounts of emissions. In the U.S., a market for trading carbon emissions—the Chicago Climate Exchange—already operates. And a bill to set up a cap-and-trade scheme, introduced by Senators John McCain and Joseph I. Lieberman (D-Conn.), is expected to win more votes than the 43 it garnered—against the odds—last year.

These steps are just the beginning, though. Even drastic measures—such as implementing revolutionary energy technologies or grabbing carbon from the air—won't stop this great global experiment from being conducted. "We won't cure this problem," cautions Henry Jacoby, co-director of Massachusetts Institute of Technology's Joint Program on the Science & Policy of Global Change. "The hope is that we can lower the risk of some of the more possible damaging outcomes." Companies and nations have begun to respond, but there is a long way to go, and only two choices: Get serious about global warming—or be prepared for the consequences. ■

–With Sarah R. Shapiro in New York

The Brokers Strike Back

They're dragging their feet in investor cases and suing ex-customers for damages

WALL STREET IS sending a tough message to investors: Beware of suing your brokers—they might just sue you back. Brokerage firms are playing hardball with investors who have filed a pile of arbitration claims since the tech stock bubble burst in 2000. Many are dragging their feet in producing documents requested by investors. Others are neglecting to pay awards if they lose or, if they win, suing investors for costs. "Cases that would have settled quickly a few years ago are being tried to the bitter end," says Charles W. Austin Jr., a Richmond (Va.) securities lawyer and president of the Public Investors Arbitration Bar Assn., an organization of investors' lawyers.

Kimberly C. Marcucci, a 47-year-old artist with a day job as a manager at a motorbike dealer in Anchorage, Alaska, ran into this resistance after she filed a claim in January, 2003. She alleged that her broker at Merrill Lynch & Co. lost her approximately $100,000 nest egg in part by plowing much of it into volatile tech stocks. Merrill delayed providing certain documents requested by her lawyer during the discovery phase despite an order from the arbitration panel.

Merrill paid dearly for its tardiness. Last January arbitrators ordered it to pay Marcucci $52,000 for failing to produce documents in a timely fashion—on top of $40,000 in compensation for the money she lost. And on July 19, Merrill was one of three firms, with Morgan Stanley and Citigroup, each fined $250,000 by the NASD for failing to produce documents in a total of 20 cases, including Marcucci's, from 2002 to 2004. Merrill spokesman Mark Herr notes that the firm's volume of arbitration cases tripled over the period, that the cases cited are less than half of 1% of the arbitrations the firm defended, and that it did provide hundreds of documents in the Marcucci case alone. "This must be kept in perspective," he says.

Still, such aggressive tactics are raising troubling questions about the arbitration system. Since the late 1960s most brokerages have required investors to agree to take any dispute to arbitration panels instead of to court. The NASD, which regulates brokers and runs most of the panels, says the system is "faster, fairer, and less expensive" for investors than going to trial. In the early days investors sometimes simply wrote the panel, and the firm responded by mail.

Now it's getting harder to tell the difference between an arbitration and a trial. Even in arbitrations, the parties often fire off flurries of motions, delays are becoming endemic, and batteries of lawyers are in attendance. "Arbitration is still a 100-yard dash compared with a trial in terms of how soon you get before a judge and jury," says New York securities lawyer Bill T. Singer. "But once you're there, they often take the same amount of ti The NASD says arbitration cases that panels now take a record 17.6 month average from start to finish, up 3% last year.

Firms are fighting back in large because damages are soaring. Many sick and tired of paying out on cla they often regard as frivolous. Bro shelled out $162 million in arbitra awards to investors last year. That ma peanuts compared with the billions top firms earn each year, but it's a l hundreds of smaller brokerages. It's more than double the $76 million aw ed in 2000 and only slightly less than record $163 million paid in 1998. D age awards could set a new high year: By June 30, securities firms ha ready been ordered to pay $109 millio their customers, according to the NAS

Not all investors are angels, ei Since January, arbitration panels h fined six investors for abusing rules quiring them to hand over docum without delay. In the same period, t have cited 16 firms for the same reas "Almost every case I handle now invo a discovery dispute on both sides," s Mark J. Astarita, a New York lawyer v represents both investors and firms.

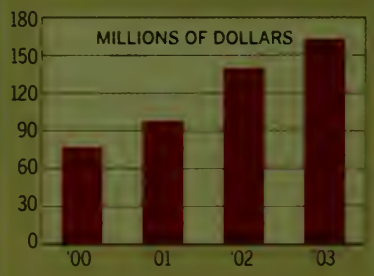
'FRIVOLOUS CASES'

FACED WITH THOUSANDS of clai firms argue that t tougher stance is play. They often beset by former c tomers who refu to accept the risks investing in the m ket and then try to coup their money blaming their b kers. That's easier do now because, the wake of the te bust, personal-inj lawyers started t ing on securities c es in return for share of any award settlement they w "Brokerages are t ing to weed out fri lous cases by forci customers to acc some risk," s Richard A. Roth, New York law who represents fi and has won f for them.

Some firms are

PLAYING HARDBALL

Arbitration awards against brokerages are soaring...



...so firms are starting to react by:

FAILING to supply documents requested during discovery

SUING losing plaintiffs to recoup legal costs

REFUSING to pony up arbitration awards

Data: NASD, BusinessWeek

after investors who break arbitration es. In January a panel awarded Birmham (Ala.)-based SouthTrust Securi- $17,511 in legal expenses and dames after an investor failed to comply h two orders to produce certain docunts. He had alleged that the firm lost 42,145 of his retirement savings. "I ver got the documents I requested, and ouldn't understand why," says Victor L. yslip, SouthTrust's lawyer. The instor's lawyer, James Richard Hooper of oper & Weiss in Orlando, did not rein repeated calls from *BusinessWeek*.

Other firms are winning damages by uing that a claim was merely frivolous. July, 2003, a panel ordered an investor pay Baltimore-based Lombard Securis Inc. $46,225 in punitive damages, atney fees, expenses, and interest for her ckless, malicious, grossly negligent bevior." Her lawyers alleged that the firm ade excessive and improper trades in a claim withdrawn later in 2001. In 2003, an NASD panel, responding to a counterclaim filed by Lombard, decided that she hadn't made any trades and that her portfolio hadn't changed while Lombard had her account. "Our board of directors was outraged and authorized us to fight this case as a matter of principle," says Daniel T. McHugh, Lombard's CEO. One year later, Lombard says it has not received a penny of the damages and fees. Manchester, (N.H.)-based McLane, Graf, Raulerson & Middleton, which represents the investor, says the attempt to enforce the award is pending in a court in Massachusetts and the award was made without any representative present on behalf of the investor. The investor's law firm says neither it nor the investor was served Lombard's claim, although the arbitration-panel ruling says otherwise.

Arbitration can be as bitter and prolonged as a normal court battle

The NASD has started cracking down on some brokers' tactics. "Since investors depend almost exclusively on the arbitration system, anytime we see discovery abuses where arbitrators see fit to levy sanctions, that is an area of increased concern to us," says Barry R. Goldsmith, the NASD's executive vice-president and director of enforcement. The NASD has temporarily suspended 122 brokers and 23 firms since 2001 for failing to pay arbitration awards. In April it charged Ann Arbor (Mich.) broker Sigma Financial Corp. and its president with violating arbitration procedures by suing a couple who had won an arbitration award against the firm. Sigma says it followed advice of counsel and that there is a difference of opinion that it is discussing with the NASD. *BusinessWeek* has learned that the Securities & Exchange Commission, which oversees the NASD, has approved two changes in NASD bylaws that will enable it to prevent brokers who leave the securities industry from reentering if they have failed to pay an arbitration award or settlement.

DOUBLE WHAMMY

SOME EXPERTS WORRY that the NASD's tough line could have an unintended consequence by building momentum for dismantling the arbitration system. Some firms may "think twice about the relative benefits of industry arbitration," says Samantha Rabin, senior editor of Securities Arbitration Commentator, an arbitration-support service in Maplewood, N.J. "Adding regulatory sanctions to what the arbitrators have already done imposes a double whammy on brokerage firms."

A total breakdown of the arbitration system isn't likely, but pressure to improve it is mounting. If investors once again had to go to court to pursue claims, proponents of arbitration argue that lawyers would be the big winners. Plaintiffs' lawyers and their clients who believe the panels too often favor the firms over the investors say the investors would come out ahead. Either way, if the system is to survive, it needs to be above reproach. And it won't be if both sides continue to bend the rules to the breaking point. ■

–By Emily Thornton in New York

What's Really Inside Krispy Kreme?

Its accounting is the target of an SEC probe—and other troubles may be in store

KRISPY KREME DOUGHnuts Inc. investors have plenty to chew on these days, and it's giving them indigestion rather than a pleasant sugar surge. Since the company warned in May of disappointing profits and then announced in July that the Securities & Exchange Commission was conducting an informal inquiry into its accounting, the once-hot stock has been in the doldrums. It trades at around $15 a share, down from nearly $50 last August.

More nasty surprises could be in store for shareholders in the Winston-Salem (N.C.) chain as the SEC probe gets going. Consider the way Krispy Kreme accounts for the franchises it buys back, on which it has spent nearly $150 million over the past year. Because much of the outlay pays for property, plant, and equipment, most food chains amortize this cost over several years. Krispy Kreme doesn't. Company documents show it has been booking most of the spending as so-called intangible assets, which don't have to be amortized. The result: Krispy Kreme's reported earnings are higher than they would have been had it written them off. "Krispy Kreme's accounting for franchise acquisitions is the most aggressive we've found," says Robert Miceli, analyst at Scottsdale (Ariz.) Camelback Research Alliance.

The company has stated that it has done nothing wrong. A spokeswoman said executives could not speak with *BusinessWeek* because of the SEC probe. But in a July 29 press release, Scott A. Livengood, chairman, chief executive, and president, said: "Krispy Kreme has no higher priority than the confidence of our shareholders, customers, and employees. We are confident in our practices."

The accounting treatment isn't the only potential problem with the acquisitions. Krispy Kreme didn't disclose that one of the owners of a Northern Cali nia franchise it bought earlier this y was Livengood's ex-wife. Nor did it id tify two of the owners of the Dallas a Shreveport, La., franchises acquired year as the brother and cousin of a ser executive. Krispy Kreme has said it lieves it wasn't required to under s rules. But, says Sanjai Bhajat, a profes of finance and corporate governance the University of Colorado: "These ki of relationships should be disclosed."

The prices paid for some of the com ny's acquisitions have also raised e brows. Krispy Kreme shelled out $67 n lion in cash for the Dallas and Shrevep franchises, a total of six stores. Th more than $11 million a store. J months before, Kris Kreme was paying an av age of $6.5 million a sto

CONFIDENT CEO Livengood defends company practices

Questions about counting started to Krispy Kreme as growth appeared to st Sales for stores open m than a year grew just 4% the first quarter end May 2, a fraction of 20% growth rate of th years ago. When the co pany gave its first-e profits warning in May blamed the low-carb cra for hurting sales. The planation doesn't ring t to all observers, who note that oth doughnut chains haven't been hit.

Krispy Kreme has been fighting ba In a July 14 presentation to investo Chief Financial Officer Michael C. Phal said the chain still had tremendous p tential for growth. It has just $3.28 a ye in revenue for each U.S. resident, half t third of the per-capita revenue at Dunk Donuts and International Dairy Que Inc. Chief Operating Officer John Ta outlined a string of new products to be i troduced over the next year such as froz beverages, coffee beans, and mini- a sugar-free doughnuts. Tate said Kris Kreme also plans to expand to Europ Japan, South Korea, and China.

Largely because of all the franchise a quisitions, Krispy Kreme's debt has sh up from $22 million to $135 million in t past four years. Fixing its business ba home—and not borrowing to e pand—may be the wisest move Krispy Kreme wants to rea sure its nervous investors. ■

–By Christopher Palm in Los Angeles, with An Borrus in Washingt

Krispy Kreme's **Crumbling** Appeal

The company's actions have raised questions

OPAQUE DEALS
Bought back part of a franchise from the CEO's ex-wife and another from an exec's brother and cousin without disclosing the relationships

PROFITS WARNING
In May, cut its earnings guidance by 10%, blaming a hit from low-carb diets, which it earlier said were having "little discernible impact"

Data: Company BusinessWeek

OMMENTARY

PAULA DWYER

'he Big Board's Big Compromise

; it's making electronic trading easier—but big investors may soon demand more

WHEN NEW YORK Stock Exchange Chief Executive John A. Thain unveiled a proposal on Aug. 2 to expand electronic ding, he said the Big Board would pro- e more options for completing a trade n any other market, along with access the world's deepest pool of buyers and lers. Well, he got the second part right.

the NYSE is still a long way from even ching the Chinese-menu array of trad- styles offered by electronic rivals.

ot that Thain's plan isn't impressive. balanced the competing interests of main constituent groups—traditional- who work on the floor and institutions want faster trades untouched by hu- s. And he did it at warp speed, com- d with predecessor Richard A. Grasso's ing steps toward computer trading. But plan is the product of a grand compro- e. Trading will be faster, but mutual ls and pension funds may have to wait s for true electronic trading at the E. "It doesn't go far enough," says Ju- W. Peake, a finance professor at the versity of Northern Colorado.

Iost specialists and floor brokers who age the NYSE's floor auctions will keep r jobs, though investors at times will be to bypass them. But floor denizens must prove that they can add value— example, by lowering trading costs—or business. Judging by the market's re- on, that may be in the offing: On Aug. seat on the NYSE sold for $1.25 mil- , down nearly 11% from early July. And shares of two specialist firms, ranche & Co. and Van der Moolen, declined 3% and 7%, re- tively, in the three days since the announcement.

he core of Thain's plan is to remove the handcuffs on Direct , the NYSE's flawed e-trading system. No longer will auto- ic trades be limited to 1,099 shares at most. Nor will cus- ers have to wait an interminable 30 seconds between trades. To sweeten the deal for institutions, which have threatened to take their business to faster and less-expensive markets, Thain will let them scoop up large blocks of stock by "sweeping the book." That means they can trade electronically not just at the best buy or sell quote but also at prices above or below that.

This mimics what NASDAQ, Archipelago, and other electronic rivals do. But only up to a point. The NYSE would install speed bumps by capping such sweeps at 9¢ above or below the best quote. This reduces the chance that prices would swing wildly. But it's also a tip of the hat to the 480 specialists who manage the floor auctions and the 400 or so independent floor brokers who could pick up business from customers wanting to trade at prices beyond the cap.

Thain nixed an important feature that most rivals have and big players wanted: the ability of institutions to disclose just a portion of a buy or sell order, trickling out the rest of the order automatically as sellers and buyers reveal their hands, too. This way, a mutual fund would be less likely to move the price against itself. An indication that Fidelity Investments is shopping for 500,000 shares of Citigroup drives up the price for Fidelity investors. While this feature would have helped big buyers remain anonymous—and lower their trading costs—it would have deprived floor brokers of even more business. So out it went.

SAFE FOR NOW Restrictions on electronic trades protect brokers

There were other trade-offs. If a fund wanted to buy 50,000 shares of General Electric Co. at $33.01, under Thain's plan it could "sweep the book" for GE sellers beyond the one offering the best quote—up to $33.10. If there were GE sellers offering good prices at rival Archipelago, the order would be routed there, but only to the seller offering the best quote. This helps the Big Board retain its share of trades in listed stocks, now at 80% after slipping to 75% in recent months, but could cost investors a bundle.

As the old saw goes, politics is the art of the possible. With this plan, Thain, who until January was president of Goldman Sachs Group Inc., is showing that he's a smart politician. His plan might be seen as a giant leap forward at the 212-year-old exchange, but it's more evolutionary than revolutionary. Still, as customers adapt to the new system, trading costs should decline and investor returns should increase, says James P. Selway III, managing director of brokerage firm White Cap Trading LLC. "It's what you would call a productivity gain in any other industry." If he's right, the pressure to change even more could become irresistible. ■

Streaking Past Expectations

Soaring profits surprised even the bulls—but the party may be winding down

EVEN BEFORE THE SPRING profit parade began, Wall Street was counting on another strong performance. But investors didn't know how much of a blowout it would be. Second-quarter earnings for the 900 companies on *BusinessWeek*'s Corporate Scoreboard gained 41% from the year before. True, the big jump was skewed because a handful of companies were coming off huge losses or acquisition-related write-offs from a year ago. But even after factoring out all one-time items, overall results were still impressive: Profits for the quarter soared 32%, the sixth straight quarter of double-digit growth.

How startling were the numbers? As late as the beginning of the quarter, on Apr. 1, analysts thought profits from continuing operations would rise by 14.9%, according to researcher Thomson First Call. Now, Michael Thompson, director of research, says profit growth fo quarter was more like 26%.

The difference between our nun and those of First Call is that Scorel profits are based on reported income continuing operations before extra nary items, as defined by generall cepted accounting principles. That d tion includes such things as asset and charges for layoffs. First Call's r bers are based on analysts' estimates exclude certain unusual items.

ROBUST REVENUES

IT TURNS OUT that analysts sharply derestimated how much the contir sales growth would help fatten the tom line. Revenues climbed 13%—fo third straight quarter of double-d gains. Of the 60 Scoreboard industrie had higher revenues. Gains were e cially notable in energy, where crud prices were at or near historic highs reinvigorated information techno sector; and among basic materials ducers, which benefited from strong ternational demand (page 76). In fact materials sector was one of the stanc performers in the quarter, with profit 86% on sales growth of 17%.

The ability to raise prices was a cru factor in the unexpectedly strong q ter, especially for oil, chemical, and r

Second-Quarter Winners and Losers

The profits surge was broad and deep: All but five of the 60 Scoreboard industries made more money than in the previous year, and airlines was the only segment to lose money

INDUSTRIES

Leaders	Percentage Change From 2003's Second Quarter
Metals & Mining	488%
Internet & Catalog Retail	393
Pharmaceuticals	338
Multiline Retail	307
Paper & Forest Products	221
Wireless Telecom Svcs.	156
Office Electronics	142
Communications Equipment	129
Auto Components	100
Computers & Peripherals	99
Construction Materials	94
Automobiles	89
Energy Equipment & Svcs.	81
Oil & Gas	76
Machinery	74

Laggards	Percentage Change From 2003's Second Quarter
Airlines	LOSS
Diversified Financial Svcs.	-86%
Containers & Packaging	-2
Food Products	-2
Thrifts & Mortgage Finance	-1
Electric Utilities	0
Road & Rail Transportation	2
Diversified Telecom Svcs.	3
IT Services	3
Media	5
Industrial Conglomerates	7
Tobacco	8
Biotechnology	8
Beverages	10
Electrical Equipment	10

COMPANIES

Who Made the Most	Millions Of Dollars
Exxon Mobil	$5,790
ChevronTexaco	4,082
General Electric	3,924
Bank of America	3,849
AIG	2,862
Pfizer	2,844
Microsoft ***	2,690
Altria Group	2,627
Johnson & Johnson	2,458
Wal-Mart Stores *	2,166
ConocoPhillips	2,013
IBM	1,990
Verizon Communications	1,797
Merck	1,768
Intel	1,757

Who Lost the Most	Millions Of Dollars
Delta Air Lines	-$1,963
J.P. Morgan Chase	-548
Gateway	-336
Motorola	-203
Northwest Airlines	-175
Baxter International	-169
Electronic Data Systems	-132
Archer Daniels Midland *	-103
Raytheon	-94
TXU	-92
Teco Energy	-82
IDT **	-77
Solectron **	-65
Schering-Plough	-65
Halliburton	-58

All Industry Composite +41% * Fiscal first quarter ** Fiscal third *** Fiscal fourth quarter

Data: Standard & Poor's Compus

tats With izzle

anks to increased pricing power, cond-quarter earnings soared

Rise in Sales	Rise in Profits	Profit Margins
+13%	+41%	7.6%

mpanies. "A lot of companies are ing pricing power, so margins are g up very nicely," says Sung Won n, chief economist at Wells Fargo & Quarterly profit margins rose to , from 6.1% the previous year.

t profit growth will probably slow iderably in the second half. On July he Commerce Dept. re- ed that the economy v at a slower-than- cted annual rate of 3% e second quarter, down a 4.5% clip in the first. sumer spending, which unts for two-thirds of economy, rose an ane- 1%, the weakest show- n three years.

Slowing gains in productivity will cool earnings

ad news out of Iraq, rising interest s, and surging oil prices—reflected in per-gallon gas in many regions— a toll on consumers. Add in subse- nt disappointing numbers on job vth, durable goods orders, housing s, and retail sales, and it looks as if economy will almost certainly lose m. "Any cooling down of economic vth necessarily means a cooling n of profits," says Stuart A. veitzer, managing director and glob- nvestment strategist at JPMorgan ning Asset Management and JP- gan Private Bank.

OIL BONANZA

REOVER, ONE OF of the biggest driv- of higher profits, productivity gains, is likely to slow. That's because as com- ies hire more workers, output per ker will inch downward. Mark M. di, chief economist at Economy.com , predicts that after expanding more 4% in both 2002 and '03, productiv- rowth will downshift to less than 2% year and next. "This is the end of the its party," predicts Zandi.

ry telling that to Big Oil, though. ming worldwide demand for its ducts is expected to keep oil prices e to the $40-a-barrel mark. Thanks ose high prices, quarterly earnings he sector rose 77%, year to year, to billion. Getting an additional boost improved margins at its U.S. re- ries, ConocoPhillips saw an 84% leap in profits, to $2 billion. Refining and marketing profit alone at the nation's largest refiner shot up 155%, to $818 million for the quarter. At ChevronTexaco Corp., profits more than doubled from the year-ago quarter, to $4.1 billion. That placed ChevronTexaco second among profit leaders this quarter. In first position was Exxon Mobil Corp., where profits picked up 39%, to $5.8 billion.

But the industry with the biggest impact on overall earnings growth was pharmaceuticals, driven by a big swing at Pfizer Inc. The drugmaker posted a $3.7 billion loss in the second quarter of 2003 after charges of $5.1 billion, mainly related to the acquisition of Pharmacia Corp. In the latest quarter, Pfizer posted profits of $2.8 billion. Meanwhile, quarterly earnings at Johnson & Johnson doubled, to $2.5 billion. Like Pfizer, J&J had a big charge a year ago—about $900 million—related to acquisitions. And despite tough competition in the market for cardiac stents from Boston Scientific Corp., J&J benefited from strong performance across its diverse portfolio, including healthy gains for its rheumatoid arthritis drug Remicade. At Merck & Co., though, profits fell 1%, to $1.8 billion, partly because of higher costs from licensing deals as Merck tries to bolster its pipeline.

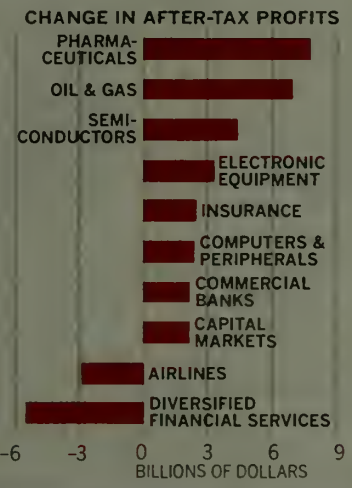
This was also a quarter when some big smokestack companies posted strong numbers. Alcoa Inc., the world's largest aluminum maker, saw a hefty 86% jump in earnings, to $404 million. Sales rose 11%, the biggest quarterly gain since 2000, driven by demand from auto makers, the aerospace industry, and the construction business. CEO Alain J. Belda expects pricing power will continue "as demand continues to grow at a robust rate" through 2007 on top of a shortage of alumina, the raw material from which aluminum is made. On July 9, Alcoa hiked prices another 5% to 10% on some aluminum alloys. All told, aluminum prices have risen about 30% in the past year. For the future, Alcoa sees much of its demand coming from China. Steel, meanwhile, has done even better, with prices nearly doubling in the past 12 months. No wonder then that U.S. Steel Corp. earned $211 million, compared with a paltry $3 million in last year's second quarter, while Nucor Corp. profits surged to $251.4 million from $8.4 million.

Tech continued to do well, as business spending on equipment and software rose at a 10% clip in the quarter. (In the previous year such spending grew by 11%.) Profits surged 15% at bellwether IBM, to $2 billion, thanks in part to

Profits Spotlight

Some sectors maintained strong performances. Others got hot when a struggling giant regained its feet

The 41% earnings gain in the second quarter marks the sixth straight quarter of double-digit profit growth—something we haven't seen since the stretch that ran from early 1999 to late 2000. Drugmakers led the way this time, with a big assist from Pfizer, which turned a $3.7 billion year-earlier loss into a $2.8 billion profit in the second quarter. Oil companies ranked a close runner-up, the beneficiaries of rising crude-oil prices. Predictably, the resulting high jet-fuel prices hurt airlines. Worst off, though, was the diversified financials sector, as both Citigroup and J.P. Morgan Chase increased litigation reserves. But why dwell on the negative? It was another bang-up quarter for corporate bottom lines.



EARNINGS

A Foreign Engine For U.S. Profits

The U.S. economy will probably start slowing this year, but the profit picture for many companies remains healthy. For that, they can thank robust growth overseas. The International Monetary Fund expects the U.S. and other world economies to grow by 4.6% this year (chart). But in 2005, U.S. real gross domestic product growth will slip to 3.9%, while world output, at 4.4%, should remain steady.

As a result, says Richard D. Rippe, chief economist at Prudential Securities, profits from Corporate America's overseas-based operations should rise next year by 10% to 15%, or by $30 billion to $45 billion. And after adding gains from U.S. exporters, the earnings promise to be even greater.

So far, the global upturn is being fueled by a revival in capital investment, which plays to the strengths of the U.S. "More and more, we are becoming capital-goods exporters," says Cliff Waldman, economist at Manufacturers Alliance/MAPI, a business research organization. Commerce Dept. figures show capital-goods exports for January to May, 2004, were 16% more than for the same period in 2003, with a 26% jump in industrial machinery leading the way. Waldman expects exports of goods and services to keep climbing at an annual pace in the low double-digits through 2005.

That's good news for companies such as 3M. The St. Paul (Minn.) conglomerate registered a record second quarter, with growth in all regions. Sales in Asia surged 18%, while Latin America, Canada, and Africa saw a 13.8% increase. In the U.S., revenues rose by a much cooler 2.7%. With 3M also able to boost margins, profits shot up 25% from the previous year. It expects a 21% increase in 2004 overall.

Moreover, the rising tide of exports and imports is a boon for shippers, helping the fortunes of such companies as United Parcel Service. Big Brown reported that second-quarter operating income from its international package business shot up 72.2% from the year before. Income from international packages now makes up over 20% of UPS operating profits.

Consumer-goods makers won't be left out in the cold. Many economists expect consumer spending to perk up next year in Europe. The IMF forecasts real GDP growth to accelerate from 2% for 2004 to 2.3%. New salads helped revitalize McDonald's Corp. sales in Europe, which grew at their fastest pace in over two years. And in Asia, even as China's government tries to cool its sizzling economy, big companies such as General Motors Corp. and YUM! Brands Inc.—owner of Taco Bell and KFC—continue to do well.

Any U.S. business with an international presence will also benefit from a cheaper dollar. Although the greenback has risen recently, it's expected to weaken again as foreign investors grow weary of financing yawning U.S. trade and budget deficits. Economist Waldman forecasts that the dollar will post quarterly declines of 5% to 7% through mid-2005, compared with a basket of other currencies. The weaker the greenback gets, the stronger overseas profits become when exchanged for U.S. currency. American exports also become comparatively cheap. That's why, even as the U.S. economy slows, higher earnings from abroad should soften the blow.

—By James Mehring in New York, with Michael Arndt in Chicago

A GROWING WORLD ECONOMY

strong growth in Asia and other over markets. At Intel Corp., the wo largest chipmaker, second-quarter e ings increased 96%, to $1.8 billion an 18% gain in sales to computer gadget makers. Boosted by strong s of high-end Macs and its hot portable music player, Apple Comp Inc.'s profits soared 221%, to $61 mil

Yet while the software business whole saw earnings climb 60% in the ond quarter, the industry also saw worst spate of disappointments sin tanked in early 2001. Why? Too m software makers vying for the same budgets. Analysts say spending appear be consolida around a handfu big software ma such as Micro Corp., whose e ings rose 81%. $2.7 billion, security speci Symantec Co which blew thro Wall Street's exp tations. Earni jumped 123%, $131.2 million, o 48% sales gain. At the other end of spectrum, PeopleSoft Inc., locked in a ye long fight to avoid a hostile takeover Oracle Corp., saw earnings tumble 70% $11 million. The battle scared off prosp tive customers.

A few big software makers got most of the business

FLYING ON FUMES

OTHER LAGGARDS included diversif financial services, media, and utilit The biggest loser was the airline sect which is being squeezed by fierce com tition and high fuel costs. Airlines rack up a $1.9 billion loss during the seco quarter vs. a $941.2 million profit the p vious year. A big contributor to that sho ing was Delta Air Lines Inc., which ported a $1.96 billion loss—the larg single loss in our survey.

As the domestic economy cools, ar lysts expect profit growth of only 15% the third quarter and 15.7% in the four according to a First Call survey. "The fa is, earnings growth will decelerate. Tha not a prediction. That's a given," says v eran earnings forecaster Charles L. H CEO of Boston's Veritas et Lux. The go news is that as long as the recovery do not fall totally off track, earnings grow will continue. It just won't provide dazzle of the past few months. ■

—By Stephanie Anderson Forest Dallas, with Amy Barrett in Philadelph and Jim Kerstetter in San Mateo, Ca

econd Quarter 2004

les growth continues to boost the bottom line

ANY SYMBOL	SALES 2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	PROFITS 2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	MARGINS 2ND QUARTER 2004 %	2ND QUARTER 2003 %	RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-29	12 MONTHS EARNINGS PER SHARE
INDUSTRY COMPOSITE	1984006.2	13	3915677.2	13	151318.1	41	294471.5	33	7.6	6.1	14.4	20	1.70
NSUMER DISCRETIONARY													
TOR COMPOSITE	406004.7	10	826434.5	10	18776.0	43	39204.9	42	4.6	3.6	11.4	21	1.52
TOMOBILES & COMPONENTS													
USTRY GROUP COMPOSITE	135602.1	8	270333.4	7	3724.8	91	7763.8	54	2.7	1.5	11.5	15	1.55
AUTO COMPONENTS													
USTRY COMPOSITE	40005.4	9	79268.0	10	924.7	100	1468.3	58	2.3	1.3	3.8	48	0.44
erican Axle & Mfg. Holdings AXL	929.6	2	1882.4	0	55.3	8	91.8	-13	5.9	5.6	19.0	10	3.35
inMeritor ARM (3)	2388.0	13	4642.0	13	53.0	13	94.0	32	2.2	2.2	13.6	9	2.19
oliv ALV	1578.6	16	3066.4	17	89.2	22	165.6	33	5.7	5.3	12.7	13	3.25
per Tire & Rubber CTB	991.8	18	1966.2	20	33.4	163	57.2	105	3.4	1.5	9.6	17	1.38
a DCN	2356.0**	15	4681.0	15	73.0	59	123.0	50	3.1	2.2	10.1	13	1.44
hi DPH	7549.0	6	14960.0	5	131.0	49	185.0	-14	1.7	1.2	-5.4	NM	-0.15
eral-Mogul FDMLQ	1576.5	10	3129.5	12	-9.0	NM	-29.4	NM	NM	NM	NM	NM	-2.04
es Lemmerz International HAYZ (11)	594.1	15	1101.5	11	-2.7	NM	-30.0	NM	NM	NM	-8.7	NA	NA
rmet INMT	217.2	19	427.8	14	-5.2	NM	-12.3	NM	NM	1.1	-63.8	NM	-3.91
nson Controls JCI (3)	6792.3	14	13412.4	17	222.3	17	380.0	18	3.3	3.2	18.2	14	3.99
r LEA	4284.0	4	8776.1	10	116.1	12	207.5	21	2.7	2.5	17.1	9	5.95
dine Mfg. MODI (9)	347.4	20	668.4	19	13.8	22	26.3	36	4.0	3.9	7.3	24	1.26
ndard Motor Products SMP	235.0	41	439.8	46	7.5	75	7.0	89	3.2	2.6	1.5	80	0.18
perior Industries International SUP	233.7	11	467.9	11	13.6	-23	27.3	-32	5.8	8.4	10.1	15	2.26
neco Automotive TEN	1116.0	12	2154.0	12	30.0	25	28.0	12	2.7	2.4	41.1	19	0.70
er Automotive TWR	783.2	5	1564.4	6	-2.7	NM	9.4	-34	NM	0.4	-29.7	NM	-2.29
N Automotive Holdings TRW	3163.0	6	6086.0	4	75.0	NM	77.0	NM	2.4	NM	NA	54	0.37
teon VC	4870.0	6	9842.0	6	31.0	NM	61.0	NM	0.6	NM	-52.9	NM	-7.73
AUTOMOBILES													
USTRY COMPOSITE	95596.7	7	191065.5	6	2800.1	89	6295.5	53	2.9	1.7	14.9	11	2.24
chmen Industries COA	234.9	35	436.1	36	5.2	82	5.8	NM	2.2	1.6	6.1	17	0.86
etwood Enterprises FLE (8)	689.4	20	1287.1	21	-17.8	NM	-27.9	NM	NM	NM	-9.0	NM	-0.58
d Motor F	42802.0	5	87493.0	7	1162.0	173	3137.0	136	2.7	1.1	20.1	12	1.30
neral Motors GM	49148.0**	7	96833.0	4	1341.0	53	2621.0	8	2.7	1.9	11.0	8	5.41
ley-Davidson HDI	1408.9**	9	2655.1	7	247.2	22	451.8	16	17.5	15.7	28.0	22	2.74
naco Coach MNC	357.8	33	712.8	31	11.9	NM	23.9	386	3.3	0.2	13.3	18	1.38
r Industries THO (5)	645.7	56	1072.2	44	32.8	63	50.3	42	5.1	4.9	20.1	19	1.67
nebago Industries WGO (4)	310.2	55	576.2	49	17.7	97	33.6	61	5.7	4.5	33.5	20	1.81
CONSUMER DURABLES & APPAREL													
USTRY GROUP COMPOSITE	49965.0	14	95477.2	15	3041.5	25	5542.5	27	6.1	5.6	18.7	14	2.60
HOUSEHOLD DURABLES													
USTRY COMPOSITE	32360.2	16	61836.5	17	2057.4	24	3879.4	28	6.4	6.0	20.5	12	3.23
erican Greetings AM (10)	445.7	-2	980.7	0	4.2	-78	52.5	-19	1.0	4.3	7.0	21	1.13
ck & Decker BDK	1297.6	19	2390.5	18	121.8	63	196.1	66	9.4	6.9	33.4	15	4.61

Second quarter ended May 31. (2) Second quarter ended Apr. 30. (3) Third quarter and most recent six months ended June 30. (4) Third quarter and most recent six months ended May 31. (5) Third quarter and recent six months ended Apr 30. (6) Fourth quarter and most recent six months ended June 30. (7) Fourth quarter and most recent six months ended May 31. (8) Fourth quarter and most recent six months ed A 30. (9) First quarter and most recent six months ended June 30 (10) First quarter and most recent six months ended May 31. (11) First quarter and most recent six months ended Apr 30. *Sales include e taxes. **Sales include other income. ***Sales include excise taxes and other income. †Revenues from major subsidiaries not included in consolidated sales. Earnings per share are for latest 12 months, not essarily for end of most recent fiscal year; they include all common-stock equivalents but exclude extraordinary items. NA = not available. NM = not meaningful.
ta: Standard & Poor's Compustat. The Global Industry Standard (GICS®) was developed by and is the exclusive property of S&P and Morgan Stanley Capital International.

The Glossary

quick guide to what is ncluded in these tables

SALES: Includes all sales and other operating revenues. For banks, includes all operating revenues.

PROFITS: Net income before extraordinary items. For banks, profits are net income after security gains or losses.

MARGINS: Net income from continuing operations before extraordinary items as percent of sales.

RETURN ON COMMON EQUITY: Ratio of net income available for common stockholders (most recent 12 months) to latest available common equity, which includes common stock, capital surplus, and retained earnings.

PRICE-EARNINGS RATIO: Based on July 29, 2004, common-stock price and corporate earnings from continuing operations before extraordinary items for most recent 12-month period.

EARNINGS PER SHARE: For most recent 12-month period. Includes all common-stock equivalents.

COMPANY	SALES				PROFITS				MARGINS				
	2ND QUARTER 2004 $ MIL	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL	CHANGE FROM 2003 %	2ND QUARTER 2004 $ MIL	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL	CHANGE FROM 2003 %	2ND QUARTER 2004 %	2ND QUARTER 2003 %	12 MONTHS ENDING 6-30	PRICE/ EARNINGS RATIO 7-29	EARNINGS PER SHARE
Blyth BTH [2]	359.0	15	845.4	22	17.7	-10	38.4	-10	4.9	6.3	14.1	19	1.8
Centex CTX [3]	2766.1**	27	5958.7	22	177.2	33	445.2	34	6.4	6.1	24.9	10	4.4
Champion Enterprises CHB	306.1	4	543.2	1	23.5	294	8.0	NM	7.7	2.0	NM	NM	-1.2
Fortune Brands FO	1824.4	21	3453.7	22	167.8	-5	307.5	11	9.2	11.7	21.9	18	4.0
Horton (D.R.) DHI [3]	2790.4	26	5125.7	24	251.3	62	439.9	55	9.0	7.0	23.6	8	3.6
Hovnanian Enterprises HOV [2]	918.8**	35	1694.0	30	70.5	34	128.2	32	7.7	7.7	29.7	7	4.3
KB Home KBH [1]	1570.4	9	2923.8	15	102.1	25	176.3	31	6.5	5.7	24.0	7	9.7
La-Z-Boy LZB [5]	544.2	1	1036.4	-1	-33.7	NM	-18.5	NM	NM	4.6	0.5	NM	0.0
Leggett & Platt LEG	1278.1	21	2465.3	18	76.8	64	139.6	45	6.0	4.4	11.4	21	1.2
Lennar LEN [1]	2342.9	11	4205.8	14	201.4	26	340.7	28	8.6	7.6	23.7	9	4.9
M.D.C. Holdings MDC	875.3	27	1638.6	30	82.6	93	143.5	80	9.4	6.2	24.0	8	8.1
Maytag MYG	1152.2	-1	2371.2	3	-41.1	NM	-2.4	NM	NM	2.2	118.8	30	0.66
Meritage MTH	433.9**	30	857.4	39	24.6	16	51.6	39	5.7	6.4	24.3	8	7.8
Mohawk Industries MHK	1486.9	19	2878.2	23	87.2	16	153.5	32	5.9	6.0	14.1	14	5.1
Newell Rubbermaid NWL	1735.8	-3	3268.1	-2	57.6	-30	91.8	-26	3.3	4.6	-2.4	NM	-0.17
NVR NVR	1003.3**	18	1881.8	18	116.0	22	216.6	18	11.6	11.2	88.7	8	54.84
Pulte Homes PHM	2518.9	29	4557.7	30	187.7	54	319.5	53	7.5	6.2	19.1	10	5.71
Ryland Group RYL	918.5	9	1673.1	12	76.5	42	128.9	40	8.3	6.4	31.1	7	10.77
Snap-on SNA	612.1	8	1228.4	11	22.2	0	34.9	-20	3.6	3.9	7.1	27	1.20
Stanley Works SWK	794.7	22	1573.3	22	61.4	560	119.9	324	7.7	1.4	17.8	19	2.27
Toll Brothers TOL [2]	818.8**	35	1416.0	20	72.4	37	122.5	25	8.8	8.7	17.4	11	3.60
Tupperware TUP	302.1	-3	598.5	3	23.7	68	38.2	86	7.8	4.5	28.3	15	1.12
Whirlpool WHR	3264.0	9	6271.0	10	106.0	13	207.0	12	3.2	3.1	34.8	10	6.20
(B) LEISURE EQUIPMENT & PRODUCTS													
INDUSTRY COMPOSITE	7609.4	11	14044.4	12	360.0	38	474.3	55	4.7	3.8	15.2	19	1.26
Brunswick BC	1422.7	33	2622.3	31	90.1	68	138.1	141	6.3	5.0	13.6	17	2.27
Eastman Kodak EK	3469.0	6	6388.0	8	143.0	35	159.0	69	4.1	3.3	8.8	26	1.01
Hasbro HAS	516.4	-11	990.7	-5	18.8	65	25.4	101	3.6	2.0	13.3	18	0.99
K2 KTO	251.0	26	528.4	48	6.2	7	16.9	186	2.5	2.9	4.6	23	0.62
MarineMax HZO [3]	219.7	17	423.0	22	10.4	23	16.1	28	4.7	4.5	13.8	16	1.58
Mattel MAT	804.0	5	1584.9	5	23.5	12	32.5	-39	2.9	2.7	26.1	15	1.18
Polaris Industries PII	422.3	12	768.3	11	24.4	16	38.7	16	5.8	5.6	36.6	19	2.57
SCP Pool POOL	504.2	17	738.8	18	43.6	28	47.7	34	8.6	7.9	28.0	24	1.68
(C) TEXTILES, APPAREL & LUXURY GOODS													
INDUSTRY COMPOSITE	9995.4	10	19596.3	10	624.2	21	1188.8	17	6.2	5.7	16.3	17	2.73
Brown Shoe BWS [11]	491.8	10	925.7	3	8.6	-5	13.7	-25	1.7	2.0	12.8	13	2.47
Jones Apparel Group JNY	1052.6	7	2270.7	3	77.6	9	172.0	-11	7.4	7.3	11.6	15	2.38
Kellwood KWD [11]	686.1	2	1207.2	1	25.0	19	37.8	28	3.6	3.1	11.2	14	2.78
Liz Claiborne LIZ	1025.9	7	2128.7	5	50.6	13	119.3	10	4.9	4.7	17.8	14	2.63
Nike NKE [7]	3487.1	17	6391.1	19	305.0	24	505.3	36	8.7	8.2	19.8	21	3.51
Phillips-Van Heusen PVH [11]	381.3	-1	738.4	6	1.6	NM	-7.6	NM	0.4	NM	-0.8	NM	-0.12
Quiksilver ZQK [2]	322.6	23	578.7	27	27.8	23	37.0	27	8.6	8.6	13.2	19	1.14
Reebok International RBK	813.6	1	1645.4	3	21.8	-15	62.9	-5	2.7	3.2	14.0	14	2.38
Skechers U.S.A. SKX	234.7	2	456.2	4	8.3	NM	15.4	143	3.6	NM	-1.0	NM	-0.09
Timberland TBL	230.2	9	552.0	14	7.9	35	39.0	55	3.4	2.7	27.6	16	3.66
VF VFC	1269.5**	12	2702.2	13	90.1	20	194.0	16	7.1	6.6	19.1	13	3.83
3 HOTELS, RESTAURANTS & LEISURE													
INDUSTRY GROUP COMPOSITE	28577.4	15	55350.7	16	2675.6	42	4611.5	44	9.4	7.6	13.1	24	1.46
Applebee's International APPB	281.9	12	559.4	14	28.2	40	57.7	29	10.0	8.1	22.1	21	1.25
Bob Evans Farms BOBE [8]	313.9	18	605.3	13	19.3	9	34.9	1	6.1	6.6	11.4	13	2.03
Caesars Entertainment CZR	1161.0	2	2357.0	6	58.0	35	121.0	46	5.0	3.8	3.0	49	0.30
Carnival CCL [1]	2256.0	68	4239.0	78	332.0	159	535.0	110	14.7	9.5	10.2	26	1.82
CBRL Group CBRL [5]	584.3	11	1197.1	10	26.2	12	55.2	15	4.5	4.4	14.1	14	2.35
Cheesecake Factory CAKE	234.9	25	455.5	26	17.8	17	34.5	24	7.6	8.1	12.7	34	1.25
CKE Restaurants CKR [11]	455.3	9	780.7	9	11.8	NM	-38.5	NM	2.6	NM	-19.5	NM	-0.52
Darden Restaurants DRI [7]	1359.2	11	2601.1	8	53.7	-12	131.6	7	4.0	5.0	18.6	16	1.36
Domino's Pizza DPZ	324.2	10	643.0	6	15.9	-9	34.3	-4	4.9	5.9	NM	60	0.23
GTECH Holdings GTK [10]	280.2	17	559.8	10	53.6	31	101.4	22	19.1	17.1	33.3	14	2.95
Harrah's Entertainment HET	1129.0	5	2238.2	5	90.2	16	172.0	9	8.0	7.2	16.5	17	2.73
Hilton Hotels HLT	1075.0	9	2079.0	9	75.0	39	112.0	78	7.0	5.5	9.3	33	0.55
International Game Technology IGT [3]	618.9	10	1255.0	15	141.1	41	258.8	37	22.8	17.8	22.9	24	1.32
Isle of Capri Casinos ISLE [8]	292.6	6	557.7	5	-4.3	NM	3.5	-87	NM	6.6	11.5	18	0.91
Landry's Restaurants LNY	317.6	6	593.3	8	21.8	29	33.2	33	6.9	5.6	8.6	16	1.90
Mandalay Resort Group MBG [11]†	729.4	18	1333.5	15	87.3	98	110.2	128	12.0	7.1	17.1	23	2.95
Marriott International MAR	2402.0	19	4654.0	15	160.0	27	274.0	29	6.7	6.3	14.0	22	2.21
McDonald's MCD	4729.0	10	9128.7	13	590.7	25	1102.2	32	12.5	11.0	14.4	19	1.40
MGM Mirage MGG	1072.5	10	2139.0	11	101.7	87	198.8	93	9.5	5.6	13.2	20	2.25
Outback Steakhouse OSI	827.9	20	1644.5	23	44.1	-1	92.4	6	5.3	6.5	16.5	18	2.24

EVOLUTION

[ANOTHER REASON PSEG HAS WALL STREET'S ATTENTION]

In the beginning, transportation was one of our primary businesses. But later it became apparent to us that energy was the industry of the future. And so it goes. Over the past 100 years, we have continued to thoughtfully evolve our business to meet changes in the marketplace as well as the needs of our shareholders and the communities we serve. Today, our focus is to provide investors with an attractive total return through a combination of steady income and long-term growth. So they can better reach their future goals.

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COMPANY	SALES 2ND QUARTER 2004 $ MIL	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL	CHANGE FROM 2003 %	PROFITS 2ND QUARTER 2004 $ MIL	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL	CHANGE FROM 2003 %	MARGINS 2ND QUARTER 2004 %	2ND QUARTER 2003 %	[illegible]	PRICE EARNINGS RATIO 29	[illegible]
Penn National Gaming PENN	301.5	4	595.3	18	24.9	29	46.4	42	8.2	6.6	19.9	24	1.5
Royal Caribbean Cruises RCL	1143.0	26	2204.7	23	122.2	119	218.0	100	10.7	6.1	8.7	23	1.9
Ruby Tuesday RI (7)	275.5	12	546.5	14	31.0	23	63.5	25	11.3	10.3	20.9	18	1.64
Ryan's Restaurant Group RYAN	216.9	4	428.9	7	14.2	-1	29.5	12	6.5	6.9	14.1	12	1.2
Starbucks SBUX (3)	1318.7	27	2559.8	29	98.1	44	177.6	48	7.4	6.6	14.6	55	0.87
Starwood Hotels & Resorts Worldwide HOT	1363.0	13	2590.0	13	120.0	38	153.0	NM	8.8	7.2	6.2	33	1.37
Station Casinos STN	240.2	14	479.1	17	29.0	41	-0.7	NM	12.1	9.8	2.7	NM	0.17
Vail Resorts MTN (5)	287.9	7	535.2	4	62.5	86	55.7	11	21.7	12.5	-0.6	NM	-0.1
Wendy's International WEN	908.9	16	1743.7	18	71.6	17	124.4	18	7.9	7.8	14.3	17	2.20
YUM! Brands YUM	2077.0	7	4047.0	8	178.0	46	320.0	33	8.6	6.3	54.8	17	2.28
4 MEDIA													
INDUSTRY GROUP COMPOSITE	40176.0	8	77394.0	9	3544.9	5	6148.6	26	8.8	9.1	5.4	30	0.97
ADVO AD (3)	318.9	10	623.2	8	13.3	-3	24.8	1	4.2	4.7	45.5	19	1.65
AMC Entertainment AEN (9)	488.6	4	891.4	-3	15.9	47	-15.1	NM	3.3	2.3	-14.8	NM	-1.19
Belo BLC	391.1	6	742.4	7	45.6	16	67.8	23	11.6	10.7	8.9	20	1.20
Clear Channel Communications CCU	2485.0	7	4454.6	9	253.8	1	370.2	15	10.2	10.8	7.9	19	1.93
Comcast CMCSA	5066.0	10	9974.0	10	262.0	NM	327.0	NM	5.2	NM	1.3	NM	0.24
Cox Communications COX	1595.2	12	3135.6	12	62.7	-47	120.4	36	3.9	8.3	-1.1	NM	-0.18
Dow Jones DJ	437.8	11	839.4	12	34.0	10	51.9	-47	7.8	7.8	94.6	28	1.52
Gannett GCI	1873.3**	10	3603.0	11	354.4	9	628.8	10	18.9	19.0	14.7	18	4.63
Harte-Hanks HHS	254.2	9	490.4	9	25.5	11	44.3	12	10.1	9.9	16.7	23	1.04
Knight-Ridder KRI	760.2	2	1472.5	2	86.3	12	142.2	11	11.3	10.4	21.0	17	3.85
McClatchy MNI	296.3	7	568.6	6	40.1	7	69.0	10	13.5	13.6	12.1	22	3.23
McGraw-Hill MHP	1230.3	5	2141.9	7	165.6	16	241.9	32	13.5	12.2	28.7	19	3.88
Media General MEG	224.9	7	433.0	6	18.5	8	27.6	16	8.2	8.2	5.5	23	2.65
New York Times NYT	823.9	3	1625.9	3	75.7	4	134.1	-5	9.2	9.1	21.3	22	1.94
Omnicom Group OMC	2407.8	12	4639.2	14	206.1	15	341.7	16	8.6	8.4	19.3	19	3.70
Regal Entertainment Group RGC	673.1	4	1213.6	3	7.4	-84	30.2	-63	1.1	7.3	167.5	21	0.92
Scholastic SCHL (7)	587.4	5	1059.4	7	22.5	-22	16.5	-41	3.8	5.1	6.8	19	1.46
Scripps (E.W.) SSP †	547.3	15	1061.0	15	86.4	34	156.9	34	15.8	13.6	16.5	27	3.79
Time Warner TWX	10888.0	10	21014.0	10	882.0	-17	1594.0	7	8.1	10.7	5.6	28	0.60
Tribune TRB	1495.9	3	2828.2	3	96.4	-58	217.1	-41	6.4	15.8	10.3	20	2.17
Valassis Communications VCI	256.8	6	494.1	10	26.8	-2	51.5	-4	10.5	11.3	84.6	15	1.94
Viacom VIA.B	6841.8	7	13614.2	9	753.8	14	1464.3	31	11.0	10.3	2.8	33	1.02
Wiley (John) & Sons JW.A (8)	232.1	14	474.4	12	10.0	21	41.4	27	4.3	4.1	21.4	23	1.41
5 RETAILING													
INDUSTRY GROUP COMPOSITE	151684.3	10	327879.3	9	5789.2	64	15138.6	49	3.8	2.6	16.0	20	1.67
(A) DISTRIBUTORS													
INDUSTRY COMPOSITE	3756.9	8	7492.9	8	158.9	18	320.7	25	4.2	3.9	14.6	17	1.74
ADESA KAR	231.0	-3	478.3	2	32.6	-4	65.9	9	14.1	14.3	11.7	14	1.35
Genuine Parts GPC	2297.7	7	4494.7	8	101.1	12	201.3	13	4.4	4.2	15.5	18	2.16
Handleman HDL (8)	297.2	14	741.1	4	6.1	97	24.7	315	2.0	1.2	11.0	16	1.38
WESCO International WCC	931.0	14	1778.8	10	19.1	158	28.8	136	2.1	0.9	23.2	19	1.06
(B) INTERNET & CATALOG RETAIL													
INDUSTRY COMPOSITE	2929.8	25	5949.0	29	279.9	393	607.7	285	9.6	2.4	17.7	73	0.85
Amazon.com AMZN	1387.3	26	2917.7	34	76.5	NM	187.6	NM	5.5	NM	NM	59	0.65
eBay EBAY	773.4	52	1529.7	55	190.4	107	390.5	99	24.6	18.0	11.1	83	0.96
Insight Enterprises NSIT	769.1	6	1501.7	5	13.0	59	29.6	95	1.7	1.1	10.6	15	1.07
(C) MULTILINE RETAIL													
INDUSTRY COMPOSITE	50799.2	1	115397.7	1	1385.2	307	4601.6	110	2.7	0.7	16.8	15	2.43
Big Lots BLI (11)	1019.2	7	2347.8	8	6.7	-34	100.5	32	0.7	1.1	7.7	17	0.75
Bon-Ton Stores BONT (11)	266.1**	88	719.7	87	-5.6	NM	18.8	54	NM	NM	7.6	13	1.12
Dillard's DDS (11)	1911.9**	2	4283.5	-1	53.8	121	104.9	9	2.8	1.3	1.7	49	0.46
Dollar General DG (11)	1748.0	11	3714.4	12	67.8	12	170.7	1	3.9	3.8	20.7	21	0.91
Dollar Tree Stores DLTR (11)	710.3	15	1603.4	15	35.2	7	115.0	15	4.9	5.3	17.4	17	1.56
Family Dollar Stores FDO (4)	1310.2	11	2713.0	12	73.8	6	155.3	9	5.6	5.9	19.5	18	1.55
Federated Department Stores FD (11)	3517.0**	7	8570.0	3	96.0	109	556.0	44	2.7	1.4	12.3	12	4.02
Fred's FRED (11)	341.5	10	719.5	13	7.4	-6	19.9	6	2.2	2.5	11.2	22	0.84
Kmart Holding KMRT (11)	4615.0	-25	10943.0	-26	93.0	NM	369.0	NM	2.0	NM	14.9	20	3.70
Kohl's KSS (11)	2380.2	12	5942.1	12	113.8	3	360.6	-8	4.8	5.2	13.7	26	1.73
May Department Stores MAY (11)	2963.0**	3	7457.0	3	76.0	6	501.0	9	2.6	2.5	10.0	19	1.38
Neiman Marcus Group NMG.A (5)	877.6**	21	1931.7	16	68.8	67	128.0	74	7.8	5.7	14.4	14	3.93
99¢ Only Stores NDN	237.3	15	467.3	16	2.6	-83	11.9	-60	1.1	7.2	8.2	27	0.54
Nordstrom JWN (11)	1575.0**	15	3548.3	12	68.7	153	173.1	99	4.4	2.0	16.4	22	2.03
Penney (J.C.) JCP (11)	4033.0	9	10131.0	7	118.0	490	371.0	91	2.9	0.5	8.3	27	1.49
Retail Ventures RVI (11)	647.9	10	1369.7	8	-1.5	NM	9.9	NM	NM	NM	3.3	65	0.12
Saks SKS (11)	1540.2	11	3509.1	9	22.0	53	103.8	26	1.4	1.0	4.4	21	0.63
Sears, Roebuck S	8781.0	-14	16575.0	-13	53.0	-83	33.0	-93	0.6	3.0	51.4	3	11.51

	SALES				PROFITS				MARGINS				
	2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	2ND QUARTER 2004 %	2ND QUARTER 2003 %	RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-29	12 MONTHS EARNINGS PER SHARE
pKo Stores SKO [11]	738.1	4	1694.1	1	-2.4	NM	29.2	-8	NM	NM	6.4	13	1.28
get TGT [11]	11587.0**	12	27158.0	11	438.0	26	1270.0	22	3.8	3.4	16.8	21	2.11
SPECIALTY RETAIL													
USTRY COMPOSITE	94198.3	15	199039.7	15	3965.2	32	9608.5	28	4.2	3.7	15.6	20	1.49
ercrombie & Fitch ANF [11]	411.9	19	972.3	10	29.7	16	124.0	5	7.2	7.4	23.6	17	2.13
erican Eagle Outfitters AEOS [11]	350.0	20	867.3	11	25.1	292	60.5	34	7.2	2.2	11.6	30	1.08
nTaylor Stores ANN [11]	433.2	23	881.9	25	31.8	77	63.3	86	7.3	5.1	13.2	17	1.59
toNation AN	4988.9	0	9689.3	4	95.6	-10	183.5	-42	1.9	2.1	9.3	12	1.33
oZone AZO [4]	1360.0	6	2519.3	5	143.4	14	235.1	15	10.5	9.8	216.9	12	6.33
mes & Noble BKS [11]	1452.8	23	3664.9	21	12.5	NM	142.5	31	0.9	NM	13.0	16	2.16
Bath & Beyond BBBY [10]	1100.9	23	2398.8	23	82.0	43	226.3	39	7.5	6.4	20.4	26	1.39
st Buy BBY [10]	5475.0	17	13924.0	19	114.0	65	583.0	30	2.1	1.5	24.3	19	2.55
ckbuster BBI	1421.2	2	2924.3	0	46.8	-24	159.4	9	3.3	4.4	-28.7	NM	-5.34
se Cascade BCC	3401.2	76	6930.8	83	50.4	NM	113.8	NM	1.5	NM	6.3	19	1.71
rders Group BGP [11]	838.1	10	2159.0	9	3.0	NM	124.9	23	0.4	NM	11.6	14	1.61
lding Materials Holding BMHC	543.4	69	960.2	60	12.6	123	16.8	169	2.3	1.8	10.6	9	2.25
Max KMX [10]	1325.0	13	2441.9	15	35.3	0	57.9	6	2.7	3.0	16.2	19	1.09
arming Shoppes CHRS [11]	592.7	5	1178.4	1	26.9	178	37.1	173	4.5	1.7	9.1	15	0.48
co's FAS CHS [11]	256.8	52	472.3	54	35.7	53	61.3	60	13.9	13.8	25.1	33	1.27
ildren's Place Retail Stores PLCE [11]	225.8	25	460.3	22	11.5	109	26.7	242	5.1	3.1	10.8	19	1.05
cuit City Stores CC [10]	2072.2	7	5331.4	4	-5.2	NM	89.4	133	NM	NM	1.8	NM	0.10
aire's Stores CLE [11]	281.6	17	645.6	15	27.7	78	79.7	37	9.8	6.5	19.6	18	1.30
le National CNJ [11]	307.7	7	617.0	6	-0.5	NM	3.8	NM	NM	NM	-5.0	NM	-0.29
K Auto CAO [11]	397.1	5	769.4	6	13.0	72	-9.6	NM	3.3	2.0	4.7	39	0.36
ck's Sporting Goods DKS [11]	364.2	20	838.6	20	10.9	64	36.9	43	3.0	2.2	24.0	29	1.11
ctronics Boutique Holdings ELBO [11]	372.4	23	1043.9	25	3.0	-4	42.5	22	0.8	1.0	15.7	14	1.82
nish Line FINL [10]	258.0	24	563.2	27	10.6	62	31.6	44	4.1	3.1	15.3	13	2.11
ot Locker FL [11]	1186.0	5	2520.0	8	47.0	21	118.0	36	4.0	3.5	15.3	15	1.44
meStop GME [11]	371.7	16	997.1	18	6.7	1	46.2	21	1.8	2.1	10.5	14	1.07
p GPS [11]	3668.0	9	8555.0	7	312.0	54	668.0	48	8.5	6.0	22.3	19	1.19
nesco GCO [11]	225.5	17	478.2	8	5.8	75	23.6	35	2.6	1.7	14.8	15	1.44
ody's Family Clothing GDYS [11]	302.9	7	672.1	5	8.1	333	15.0	162	2.7	0.7	10.1	12	0.71
me Depot HD [11]	17550.0	16	32675.0	15	1098.0	21	2049.0	29	6.3	6.0	20.0	17	1.97
-Ann Stores JAS [11]	404.9	8	957.5	6	6.7	63	33.8	15	1.7	1.1	12.0	14	1.90
nited Brands LTD [11]	1978.2	7	5209.0	8	96.6	-1	484.5	7	4.9	5.3	16.4	15	1.37
nens 'n Things LIN	578.7	11	1131.5	13	0.9	-85	0.9	-88	0.2	1.1	8.8	18	1.51
thia Motors LAD	682.3	7	1320.1	10	10.8	25	18.3	42	1.6	1.3	10.8	11	2.17
we's LOW [11]	8681.0	22	15933.0	21	455.0	9	856.0	16	5.2	5.9	18.1	21	2.37
en's Wearhouse MW [11]	360.7	15	783.4	11	15.1	37	33.6	9	4.2	3.5	10.7	19	1.42
chaels Stores MIK [11]	725.9	11	1789.0	10	29.3	41	123.9	29	4.0	3.2	15.5	20	2.66
fice Depot ODP	3162.3	12	6767.5	15	79.9	34	195.4	19	2.5	2.1	11.2	16	1.06
Reilly Automotive ORLY	435.2	11	838.5	14	32.7	21	59.8	28	7.5	6.8	13.2	20	2.05
cific Sunwear of California PSUN [11]	245.1	24	571.4	23	15.0	88	49.3	58	6.1	4.0	21.5	19	1.10
yless ShoeSource PSS [11]	722.0	3	1366.4	1	13.8	-2	-3.4	NM	1.9	2.0	-0.1	NM	0.00
p Boys-Manny, Moe & Jack PBY [11]	566.1	11	1095.8	12	16.2	NM	12.3	NM	2.9	NM	1.6	NM	0.18
etco Animal Supplies PETC [11]	425.9	14	881.5	13	15.8	42	36.7	20	3.7	3.0	100.3	25	1.19
etsmart PETM [11]	796.3	14	1636.0	14	35.8	46	93.1	89	4.5	3.5	17.5	30	1.02
er 1 Imports PIR [10]	432.0**	7	987.3	7	11.7	-38	60.0	-18	2.7	4.7	16.4	15	1.21
adioShack RSH	1053.8	3	2146.4	2	68.3	19	136.6	20	6.5	5.6	38.7	15	1.94
ent-A-Center RCII	573.0	4	1158.4	3	51.2	45	103.4	20	8.9	6.4	23.1	12	2.39
oss Stores ROST [11]	991.9	13	2090.6	13	48.5	-2	122.3	13	4.9	5.6	30.0	16	1.48
ush Enterprises RUSHB	267.2	38	497.1	41	4.1	75	6.2	93	1.5	1.2	12.2	17	0.80
herwin-Williams SHW	1618.0	10	2937.5	12	126.4	15	177.9	26	7.8	7.5	25.4	16	2.52
onic Automotive SAH	1877.2	3	3580.9	5	30.9	8	53.3	12	1.6	1.6	12.9	11	1.98
ports Authority TSA [11]	572.0	150	1284.0	135	4.1	-3	18.6	9	0.7	1.8	3.6	31	0.81
tage Stores STGS [11]	289.7	46	658.2	45	18.9	41	38.5	31	6.5	6.8	12.9	13	2.93
taples SPLS [11]	3452.2	12	7133.3	11	125.7	408	337.6	78	3.6	0.8	16.5	24	1.18
tein Mart SMRT [11]	363.6	11	773.8	5	11.7	597	26.6	118	3.2	0.5	5.8	58	0.32
abots TLB [11]	419.0**	6	850.6	3	33.3	13	55.3	-4	8.0	7.4	17.3	16	1.88
BC TBCC	456.5	39	890.3	52	9.1	14	14.6	16	2.0	2.4	12.4	16	1.50
iffany TIF [11]	457.0**	15	1188.5	17	40.3	12	150.8	20	8.8	9.1	14.7	24	1.48
JX TJX [11]	3352.7	20	7458.3	18	168.1	48	406.9	52	5.0	4.1	45.0	17	1.40
oys 'R' Us TOY [11]	2058.0	-3	6995.0	0	-28.0	NM	116.0	-54	NM	NM	1.6	52	0.31
ractor Supply TSCO	525.9	17	856.5	18	31.4	15	35.2	20	6.0	6.1	18.6	24	1.55
rans World Entertainment TWMC [11]	304.5	11	846.5	12	2.0	NM	36.9	NM	0.7	NM	6.5	15	0.69
nited Auto Group UAG	2458.6	12	4814.9	18	32.5	37	53.2	31	1.3	1.1	9.8	12	2.28
est Marine WMAR	252.6	8	381.8	11	25.2	27	22.1	62	10.0	8.5	9.9	15	1.35

COMPANY SYMBOL	SALES 2ND QUARTER 2004 $ MIL	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL	CHANGE FROM 2003 %	PROFITS 2ND QUARTER 2004 $ MIL	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL	CHANGE FROM 2003 %	MARGINS 2ND QUARTER 2004 %	2ND QUARTER 2003 %	EARNINGS 12 MONTHS ENDING 6-30	PRICE EARNINGS RATIO 7-29	EAR P SH
Williams-Sonoma WSM (11)	640.9	19	1645.2	18	21.4	60	123.5	33	3.3	2.5	20.0	23	1.
Zale ZLC (5)	483.2	8	1432.2	5	11.5	23	108.8	NM	2.4	2.1	15.7	14	1.
CONSUMER STAPLES													
SECTOR COMPOSITE	270664.7	10	537637.7	11	15699.9	11	29810.9	9	5.8	5.8	23.2	20	2.0
6 FOOD & STAPLES RETAILING													
INDUSTRY GROUP COMPOSITE	145491.5	10	295291.7	9	3464.3	13	6890.6	-1	2.4	2.3	15.9	27	1.
Albertson's ABS (11)	8688.0	-2	17338.0	-4	56.0	-68	186.0	-50	0.6	1.9	8.2	20	1.
BJ's Wholesale Club BJ (11)	1647.6	12	3576.9	12	16.3	28	65.6	6	1.0	0.9	12.6	15	1.5
Casey's General Stores CASY (8)	602.5*	11	1147.9	9	0.8	-85	6.7	-50	0.1	1.0	8.3	23	0.7
Costco Wholesale COST (4)	10897.2**	14	22446.2	14	198.7	29	425.5	27	1.8	1.6	11.4	24	1.
Duane Reade DRD	365.2	3	714.8	4	3.0	-27	4.3	-40	0.8	1.1	0.7	NM	0.0
Foodarama FSM (2)	279.0	10	573.8	12	1.0	647	2.2	360	0.3	0.1	9.7	12	3.
Great Atlantic & Pacific Tea GAP (10)	3286.2	2	5985.9	7	-41.5	NM	-102.7	NM	NM	NM	-67.6	NM	-6.0
Kroger KR (11)	16905.0	4	29938.0	4	263.0	-25	-74.0	NM	1.6	2.2	5.5	52	0.3
Longs Drug Stores LDG (11)	1159.7	5	2386.3	5	9.2	59	22.7	85	0.8	0.5	4.7	24	0.8
Nash Finch NAFC	906.4**	2	1785.8	2	-15.6	NM	-10.9	NM	NM	0.8	5.4	25	1.0
Pantry PTRY (3)	935.9*	32	1730.3	25	13.7	125	-0.4	NM	1.5	0.9	7.9	39	0.5
Pathmark Stores PTMK (11)	990.1	-1	2002.6	0	-1.8	NM	7.8	-11	NM	0.1	3.7	16	0.4
Rite Aid RAD (10)	4244.4	5	8640.7	6	63.3	NM	122.5	NM	1.5	NM	NM	18	0.2
Safeway SWY	8361.1	1	15999.9	-2	155.2	-4	198.3	-39	1.9	2.0	-8.8	NM	-0.6
7-Eleven SE	3159.0**	16	5908.1	13	48.1	19	58.9	25	1.5	1.5	29.0	20	0.8
Smart & Final SMF	457.8	17	881.3	18	8.3	NM	14.9	NM	1.8	NM	14.0	14	1.0
Spartan Stores SPTN (9)	474.3*	3	931.2	3	1.7	NM	0.2	NM	0.4	NM	-1.1	NM	-0.0
Supervalu SVU (10)	5910.6	1	10954.4	5	149.4	103	245.0	78	2.5	1.3	15.0	11	2.6
United Natural Foods UNFI (5)	448.9	23	842.1	20	8.6	49	15.6	39	1.9	1.6	12.4	33	0.6
Village Super Market VLGEA (5)	229.5	4	471.7	4	2.7	45	6.4	8	1.2	0.9	10.0	9	3.7
Walgreen WAG (4)	9578.5	15	19360.7	15	344.6	16	778.1	17	3.6	3.6	16.4	29	1.2
Wal-Mart Stores WMT (11)	65443.0**	14	140633.0	13	2166.0	18	4888.0	14	3.3	3.2	21.7	25	2.1
Weis Markets WMK	521.4	3	1042.0	2	13.6	-1	29.9	1	2.6	2.7	9.4	16	2.0
7 FOOD, BEVERAGE & TOBACCO													
INDUSTRY GROUP COMPOSITE	99486.9	11	191364.1	11	9251.8	6	16973.9	8	9.3	9.7	23.6	17	2.2
(A) BEVERAGES													
INDUSTRY COMPOSITE	28419.7	6	52830.8	9	3915.0	10	6721.3	16	13.8	13.4	29.5	21	2.0
Anheuser-Busch BUD	4010.0	6	7487.0	6	673.5	6	1223.4	9	16.8	16.8	80.2	19	2.6
Brown-Forman BF.B (8)	534.3	9	1128.2	9	57.8	-1	138.3	8	10.8	11.9	23.8	22	2.1
Coca-Cola KO	5965.0	5	11043.0	8	1584.0	16	2711.0	23	26.6	23.9	32.4	22	1.9
Coca-Cola Bottling Consolidated COKE	333.7	5	616.4	4	10.6	-11	13.4	1	3.2	3.7	57.0	16	3.40
Coca-Cola Enterprises CCE	4844.0	5	9083.0	10	203.0	-22	307.0	7	4.2	5.6	14.4	14	1.4
Constellation Brands STZ (10)	927.3	20	1808.6	27	51.3	31	114.2	25	5.5	5.1	9.7	18	2.07
Coors (Adolph) RKY	1150.7	5	2074.2	8	72.0	-6	76.9	0	6.3	6.9	12.8	14	4.72
Pepsi Bottling Group PBG	2675.0	6	4742.0	8	142.0	8	192.0	13	5.3	5.2	24.7	17	1.64
PepsiAmericas PAS	909.7	4	1647.3	6	61.7	16	82.2	41	6.8	6.1	12.2	15	1.26
PepsiCo PEP	7070.0	8	13201.0	9	1059.0	12	1863.0	13	15.0	14.4	29.5	23	2.17
(B) FOOD PRODUCTS													
INDUSTRY COMPOSITE	54157.5	15	105668.3	14	2555.9	-2	5155.1	1	4.7	5.5	15.3	18	1.72
Archer Daniels Midland ADM (6)	9686.0	20	18995.0	19	-103.1	NM	123.7	-42	NM	1.2	6.3	21	0.76
Bunge BG	6657.0	28	12396.0	24	112.0	-38	182.0	-18	1.7	3.5	13.6	11	3.59
Campbell Soup CPB (5)	1667.0	4	3767.0	7	142.0	10	377.0	5	8.5	8.1	75.6	16	1.61
ConAgra Foods CAG (7)	3962.4	9	7560.1	4	199.0	-8	390.8	-6	5.0	6.0	16.4	17	1.50
Del Monte Foods DLM (8)	915.9	21	1727.0	33	54.3	117	106.5	125	5.9	3.3	14.2	14	0.76
Fresh Del Monte Produce FDP	763.6	9	1477.4	10	59.4	-27	106.4	-37	7.8	11.6	15.6	9	2.84
General Mills GIS (7)	2789.0	10	5492.0	6	278.0	24	520.0	12	10.0	8.8	20.1	16	2.75
Heinz (H.J.) HNZ (8)	2331.4	6	4428.6	3	198.4	93	400.6	72	8.5	4.7	41.1	17	2.20
Hershey Foods HSY	893.7	5	1906.8	6	147.2	106	254.4	50	16.5	8.4	41.8	23	2.07
Hormel Foods HRL (2)	1143.1	14	2278.7	13	53.7	59	105.5	31	4.7	3.4	15.8	20	1.50
Kellogg K	2387.3	6	4777.8	9	237.4	16	457.2	24	9.9	9.1	50.5	20	2.12
Kraft Foods KFT	8205.0	5	15898.0	5	698.0	-26	1258.0	-30	8.5	12.1	10.2	18	1.70
McCormick MKC (1)	596.2	13	1168.5	15	42.9	11	81.0	13	7.2	7.3	26.0	24	1.46
Pilgrim's Pride PPC (3)	1448.0	122	2832.9	121	9.8	-44	42.8	52	0.7	2.7	9.2	19	1.47
Sanderson Farms SAFM (2)	272.7	36	499.2	30	33.4	161	52.4	189	12.3	6.4	35.0	11	4.47
Smithfield Foods SFD (8)	2522.0	44	5225.7	47	71.1	NM	113.2	NM	2.8	0.2	10.1	19	1.46
Smucker (J.M.) SJM (8)	325.4	-1	680.7	2	22.2	-5	53.5	4	6.8	7.1	9.2	19	2.21
Tyson Foods TSN (3)	6634.0	5	12787.0	5	161.0	104	280.0	85	2.4	1.2	11.4	14	1.36
Wrigley (Wm.) Jr. WWY	957.9	21	1770.1	21	139.2	11	250.2	12	14.5	15.9	25.5	29	2.10

SYMBOL	SALES 2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	PROFITS 2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	MARGINS 2ND QUARTER 2004 %	2ND QUARTER 2003 %	RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-29	12 MONTHS' EARNINGS PER SHARE
OBACCO													
USTRY COMPOSITE	16909.7	6	32865.0	7	2780.9	8	5097.5	5	16.4	16.1	35.2	11	4.40
ia Group MO	16445.0	6	31967.0	7	2627.0	8	4821.0	4	16.0	15.7	33.9	10	4.58
UST	464.7	7	898.0	5	153.9	19	276.5	15	33.1	29.7	NM	18	2.13
USEHOLD & PERSONAL PRODUCTS													
STRY GROUP COMPOSITE	25686.4	14	50982.0	16	2983.8	29	5946.5	25	11.6	10.3	40.0	22	2.22
OUSEHOLD PRODUCTS													
USTRY COMPOSITE	20269.6	14	40482.1	16	2253.7	29	4637.2	23	11.1	9.9	37.3	21	2.52
gate-Palmolive CL	2571.7	5	5085.2	6	373.9	4	712.4	4	14.5	14.6	272.3	21	2.53
rgizer Holdings ENR (3)	651.9	10	1244.8	30	38.7	121	92.1	82	5.9	2.9	27.2	14	2.81
berly-Clark KMB	3775.7	7	7574.8	8	454.3	9	913.6	12	12.0	11.8	26.5	18	3.55
cter & Gamble PG (6)	12962.0	19	25991.0	20	1374.0	44	2902.0	30	10.6	8.7	35.2	23	2.32
ovac ROV (3)	308.3	48	586.3	43	12.8	341	17.1	443	4.2	1.4	19.5	18	1.50
ERSONAL PRODUCTS													
USTRY COMPOSITE	5416.8	11	10499.9	13	730.1	28	1309.2	33	13.5	11.7	55.4	26	1.54
erto-Culver ACV (3)	823.2	12	1642.5	14	51.5	21	92.0	14	6.3	5.8	11.1	31	1.53
n Products AVP	1866.3	13	3631.1	16	232.3	35	380.4	41	12.4	10.4	130.2	26	1.63
ette G	2443.0	8	4678.0	11	426.0	26	802.0	33	17.4	15.0	64.1	25	1.55
Skin Enterprises NUS	284.2	18	548.2	19	20.3	21	34.8	18	7.1	7.0	22.6	28	0.97
ERGY													
TOR COMPOSITE	191822.9	29	369084.1	19	16773.8	77	30047.8	34	8.7	6.4	19.7	14	3.79
ERGY													
USTRY GROUP COMPOSITE	191822.9	29	369084.1	19	16773.8	77	30047.8	34	8.7	6.4	19.7	14	3.79
ENERGY EQUIPMENT & SERVICES													
USTRY COMPOSITE	13590.2	25	27300.6	31	707.4	81	1277.9	51	5.2	3.6	7.7	49	0.91
ker Hughes BHI	1499.0	15	2886.6	16	116.3	41	210.7	60	7.8	6.3	7.4	51	0.78
Services BJS (3)	658.7	21	1305.7	21	129.3	161	202.6	115	19.6	9.1	17.7	25	1.99
per Cameron CAM	544.6**	36	1007.1	32	18.7	-10	35.9	23	3.4	5.2	5.8	44	1.15
liburton HAL	4956.0	38	10475.0	57	-58.0	NM	18.0	-82	NM	1.2	14.7	53	0.59
e Star Technologies LSS	246.2	74	426.0	58	32.2	NM	40.2	NM	13.1	NM	-4.3	NM	-0.41
verick Tube MVK	348.1	79	659.4	59	58.0	NM	88.3	NM	16.7	0.5	23.1	11	2.60
ors Industries NBR	530.7	23	1123.7	27	46.3	60	118.1	53	8.7	6.7	8.8	31	1.51
ble NE	253.0	2	498.4	1	34.4	-21	62.6	-25	13.6	17.6	6.5	35	1.10
lumberger SLB	2856.3	12	5551.2	13	254.7	75	358.5	22	8.9	5.7	9.6	70	0.92
ith International SII	1064.5	21	2082.2	23	27.5	-8	72.3	40	2.6	3.4	11.1	41	1.43
nsocean RIG	633.2	5	1285.2	5	48.0	NM	70.7	NM	7.6	NM	1.2	NM	0.27
OIL & GAS													
USTRY COMPOSITE	178232.7	29	341783.5	18	16066.4	76	28769.9	33	9.0	6.6	21.1	12	4.39
erada Hess AHC	3803.0	19	8291.0	11	281.0	346	562.0	123	7.4	2.0	13.7	11	7.89
adarko Petroleum APC	1443.0	16	2903.0	16	406.0	34	799.0	19	28.1	24.2	15.5	11	5.40
ache APA	1247.4	19	2400.2	19	373.1	53	722.2	30	29.9	23.4	18.5	12	3.83
hland ASH (3)†	2204.0	9	4025.0	10	167.0	135	156.0	359	7.6	3.5	10.2	14	3.64
rlington Resources BR	1333.0	26	2641.0	21	379.0	36	733.0	21	28.4	26.3	24.0	11	3.49
esapeake Energy CHK	574.3	34	1137.4	41	97.2	18	209.7	37	16.9	19.1	22.3	12	1.27
evronTexaco CVX	34703.0	27	65930.0	18	4082.0	158	6606.0	80	11.8	5.8	27.0	10	9.85
nocoPhillips COP	27343.0	25	53321.0	17	2013.0	84	3616.0	53	7.4	5.0	16.3	9	8.57
xon Mobil XOM	64179.0	25	125365.0	15	5790.0	39	11230.0	5	9.0	8.1	23.5	14	3.27
rr-McGee KMG	1097.1	4	2213.4	3	110.6	58	262.8	51	10.1	6.6	6.8	16	3.21
nder Morgan KMI †	236.9	-6	589.5	3	104.4	11	231.4	13	44.1	37.4	14.9	18	3.27
arathon Oil MRO	11376.0	33	20976.0	19	348.0	48	606.0	17	3.1	2.7	14.9	11	3.42
rphy Oil MUR	2095.8	71	3743.8	51	168.1	132	248.8	60	8.0	5.9	18.6	19	4.04
cidental Petroleum OXY	2750.0	21	5330.0	15	581.0	55	1068.0	39	21.1	16.5	22.4	10	4.80
go Producing PPP	326.9	10	634.8	4	65.2	-18	136.8	-21	19.9	26.8	17.0	11	4.05
emcor PCO	3573.7	66	6125.4	49	135.0	291	185.0	142	3.8	1.6	19.4	13	2.89
noco SUN	5694.0	54	10428.0	33	234.0	189	323.0	93	4.1	2.2	25.9	11	6.11
lero Energy VLO	13807.6	56	24889.1	34	632.7	393	880.8	195	4.6	1.5	19.1	8	8.92
O Energy XTO	445.0	59	840.0	57	99.1	73	193.2	59	22.3	20.4	15.9	20	1.50
ANCIALS													
CTOR COMPOSITE	255507.2	9	504086.6	10	35417.8	6	75190.3	17	13.9	14.3	15.0	14	3.15
BANKS													
DUSTRY GROUP COMPOSITE	68309.2	4	133812.2	4	15267.8	16	29358.5	14	22.4	20.0	15.7	13	3.52
COMMERCIAL BANKS													
DUSTRY COMPOSITE	58092.1	9	111453.2	7	12910.7	20	24620.5	16	22.2	20.3	15.3	14	3.41
nSouth Bancorporation ASO	742.9**	1	1488.0	2	167.0	8	327.1	5	22.5	21.1	19.5	13	1.82
ssociated Banc-Corp ASBC	234.0	-7	463.6	-7	64.5	14	124.1	8	27.6	22.5	17.3	14	2.14
ank of America BAC	16448.0	34	28737.0	21	3849.0	41	6530.0	27	23.4	22.3	12.7	11	7.45

COMPANY	SALES				PROFITS				MARGINS				
	2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	2ND QUARTER 2004 %	2ND QUARTER 2003 %	[illegible]	PRICE EARNINGS RATIO 1-29	[illegible]
Banknorth Group BNK	398.6	-5	779.5	-3	95.8	10	186.2	10	24.0	20.9	12.8	15	2.1
BB&T BBT	1693.1	12	3251.7	8	400.1	27	728.6	13	23.6	21.0	10.9	19	2.0
BOK Financial BOKF	216.6	-5	442.4	-2	45.5	12	84.7	1	21.0	17.8	12.2	17	2.38
Charter One Financial CF	647.6**	-10	1142.7	-20	166.3	0	216.6	-31	25.7	23.1	16.1	19	2.3
Colonial BancGroup CNB	237.5	3	468.9	3	43.3	15	82.4	12	18.3	16.3	12.4	16	1.25
Comerica CMA	766.0	-10	1529.0	-11	192.0	13	354.0	2	25.1	19.9	13.6	15	3.80
Commerce Bancorp CBH	384.3**	27	742.6	27	66.2	46	128.2	45	17.2	15.0	17.6	17	2.9
Commerce Bancshares CBSH	236.7**	1	471.5	2	53.8	7	105.2	8	22.7	21.6	15.2	15	3.1
Compass Bancshares CBSS	463.0	3	915.6	2	91.7	5	178.0	5	19.8	19.4	18.3	16	2.7
Fifth Third Bancorp FITB	1601.3	-2	3217.8	0	447.7	8	878.0	9	28.0	25.3	19.7	16	3.0
First Horizon National FHN	630.1	-12	1254.3	-11	118.4	0	237.7	0	18.8	16.6	24.7	12	3.6
Hibernia HIB	341.4	11	649.4	6	73.4	20	139.4	19	21.5	19.9	15.2	14	1.7
Huntington Bancshares HBAN	542.3	-9	1095.9	-8	110.1	14	214.3	14	20.3	16.2	17.3	14	1.77
KeyCorp KEY	1358.0	-7	2728.0	-5	239.0	6	489.0	11	17.6	15.5	13.9	14	2.2
M&T Bank MTB	792.9	-2	1567.2	14	184.4	38	343.9	37	23.3	16.6	11.8	17	5.46
Marshall & Ilsley MI	728.6	7	1431.1	5	151.7	13	297.8	13	20.8	19.7	16.9	15	2.55
National City NCC	2261.4	-11	4723.0	-8	519.0	-11	1229.4	0	23.0	23.1	20.5	11	3.43
National Commerce Financial NCF	387.1	1	767.5	2	85.1	19	175.3	29	22.0	18.7	11.7	21	1.58
North Fork Bancorporation NFB	338.6**	3	647.9	-2	109.0	13	211.5	6	32.2	29.1	17.7	15	2.67
PNC Financial Services Group PNC	1568.0	7	3145.0	6	304.0	65	632.0	42	19.4	12.5	16.8	12	4.31
Popular BPOP	691.2	1	1355.2	2	127.8	-5	246.3	5	18.5	19.8	17.1	13	1.77
Regions Financial RF	885.2	-6	1786.4	-4	162.0	-2	330.6	2	18.3	17.5	14.8	13	2.36
SouthTrust SOTR	816.7	4	1548.1	-1	194.7	11	377.7	9	23.8	22.3	16.5	18	2.19
SunTrust Banks STI	1810.7	2	3579.7	1	364.8	10	723.3	10	20.1	18.7	13.9	13	4.94
Synovus Financial SNV	648.6	6	1295.3	8	105.1	9	209.3	12	16.2	15.7	16.6	19	1.35
TCF Financial TCB	276.1**	0	540.5	-4	65.2	8	125.9	5	23.6	21.8	23.6	19	3.19
U.S. Bancorp USB	3477.9	-8	7054.3	-6	1036.9	13	2045.3	14	29.8	24.1	21.2	14	2.05
UnionBanCal UB	772.4	20	1428.2	12	157.5	9	388.6	39	20.4	22.5	15.6	12	4.63
Wachovia WB	6618.0**	13	13374.0	15	1252.0	21	2503.0	22	18.9	17.6	14.4	13	3.54
Wells Fargo WFC	8269.0	6	16224.0	6	1714.0	12	3481.0	15	20.7	19.5	18.8	15	3.90
Westcorp WES	338.5	0	680.9	1	54.4	72	97.8	77	16.1	9.4	13.6	13	3.30
Zions Bancorporation ZION	469.8	3	927.2	3	98.8	7	198.5	10	21.0	20.3	13.6	15	3.95
(B) THRIFTS & MORTGAGE FINANCE													
INDUSTRY COMPOSITE	10217.1	-20	22359.0	-7	2357.1	-1	4738.0	3	23.1	18.6	17.8	11	4.16
Astoria Financial AF	280.4	-7	563.7	-7	57.5	13	110.9	3	20.5	16.9	14.5	13	2.64
Countrywide Financial CFC	2319.5	-45	6473.6	-9	699.6	83	1390.6	96	30.2	9.0	32.3	7	10.14
Golden West Financial GDW	1058.9**	11	2058.4	8	316.7	16	616.4	16	29.9	28.6	18.1	14	7.69
GreenPoint Financial GPT	455.6	0	885.9	-2	123.0	-5	235.5	-8	27.0	28.4	22.9	11	3.74
Hudson City Bancorp HCBK	224.7	11	441.4	9	58.4	11	114.6	9	26.0	25.9	16.9	30	1.17
Independence Community Bank ICBC	218.1	57	363.1	32	58.2	71	96.4	44	26.7	24.5	7.7	13	2.80
MGIC Investment MTG	403.1**	-7	818.6	-3	154.5	7	284.6	0	38.3	33.3	12.4	14	4.98
New Century Financial NCEN †	414.8	93	775.8	96	102.4	68	189.6	78	24.7	28.2	44.2	6	8.21
Radian Group RDN †	322.8	2	655.7	9	120.5	8	240.5	11	37.3	35.4	12.3	11	4.31
Sovereign Bancorp SOV	639.7**	3	1266.4	2	131.4	26	233.6	30	20.5	16.8	11.9	15	1.50
Washington Mutual WM	3646.0	-22	7604.0	-17	489.0	-51	1137.0	-42	13.4	21.3	14.3	12	3.28
Webster Financial WBS	233.5**	5	452.5	2	45.8	13	88.2	9	19.6	18.2	11.8	13	3.59
11 DIVERSIFIED FINANCIALS													
INDUSTRY GROUP COMPOSITE	98074.9	11	195467.0	12	9852.7	-22	26324.9	9	10.0	14.2	16.5	14	2.82
(A) CAPITAL MARKETS													
INDUSTRY COMPOSITE	42734.7	15	86090.1	17	6236.6	51	12825.7	60	14.6	11.0	17.1	12	3.04
Ameritrade Holding AMTD (3)	222.7	15	472.1	37	62.3	25	143.2	141	28.0	25.8	22.8	18	0.63
Bank of New York BK	1767.0	11	3436.0	14	371.0	26	735.0	25	21.0	18.5	14.8	17	1.68
Bear Stearns BSC (1)	2063.8	12	4145.2	12	347.8	24	708.9	28	16.9	15.2	17.0	9	9.56
E*Trade Financial ET	510.1	2	1041.7	10	91.6	559	181.2	440	18.0	2.8	16.6	12	0.91
Edwards (A.G.) AGE (10)	661.9	19	1355.0	27	46.3	66	100.7	105	7.0	5.0	10.0	15	2.22
Federated Investors FII	213.7	9	435.1	13	48.6	1	99.8	4	22.8	24.6	43.3	16	1.74
Franklin Resources BEN (3)	862.8**	26	1737.4	34	173.9	32	346.7	44	20.2	19.2	13.6	18	2.65
Goldman Sachs Group GS (1)	7676.0	28	15581.0	29	1187.0	71	2480.0	83	15.5	11.6	17.8	11	8.02
Janus Capital Group JNS †	258.8	5	533.2	12	130.2	158	110.9	24	50.3	20.6	36.5	3	4.23
Jefferies Group JEF	277.2	20	580.3	40	31.8	70	63.7	93	11.5	8.1	12.7	17	1.85
Legg Mason LM (9)	554.9	28	1131.4	37	86.4	48	178.3	68	15.6	13.5	20.4	19	4.25
Lehman Brothers Holdings LEH (1)	5228.0	17	10353.0	21	609.0	39	1279.0	73	11.6	9.8	17.0	9	7.75
Mellon Financial MEL	1169.0**	4	2434.0	10	176.0	2	420.0	24	15.1	15.4	20.2	15	1.78
Merrill Lynch MER	7376.0	1	15363.0	8	1078.0	10	2330.0	44	14.6	13.4	15.7	11	4.54
Morgan Stanley MWD (1)	9802.0	19	19279.0	14	1223.0	104	2449.0	63	12.5	7.3	17.5	12	4.28
Northern Trust NTRS	695.9	4	1376.8	6	130.8	61	258.0	45	18.8	12.1	15.8	18	2.25
Price (T. Rowe) Group TROW	310.5	30	616.9	35	80.3	49	157.6	70	25.9	22.6	19.5	21	2.22

	SALES				PROFITS				MARGINS				
	2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	2ND QUARTER 2004 %	2ND QUARTER 2003 %	RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE-EARNINGS RATIO 7-29	12 MONTHS EARNINGS PER SHARE
ymond James Financial RJF (3)	451.5	16	942.9	27	29.6	26	72.7	88	6.6	6.0	12.6	13	1.75
wab (Charles) SCH	1164.0**	8	2407.0	18	113.0	-10	274.0	37	9.7	11.6	11.7	22	0.40
ate Street STT	1469.0**	14	2869.0	15	220.0	NM	437.0	499	15.0	NM	18.4	14	3.21
CONSUMER FINANCE													
DUSTRY COMPOSITE	15036.0	7	29692.2	7	2731.6	31	5100.0	27	18.2	14.9	23.2	15	2.60
nerican Express AXP	7258.0	14	14168.0	14	876.0	15	1741.0	20	12.1	12.0	21.9	20	2.53
pital One Financial COF	2548.0	7	5155.9	8	407.4	42	858.2	44	16.0	12.0	19.6	12	5.76
BNA KRB	2967.2	6	5942.8	7	660.3	22	1180.0	21	22.3	19.3	22.0	13	1.95
ovidian Financial PVN	671.4	-2	1316.4	-10	69.7	79	171.4	292	10.4	5.7	13.0	12	1.11
M SLM	1122.8	-11	2154.6	-14	614.9	65	906.4	15	54.8	29.5	54.8	11	3.33
udent Loan STU	223.7	6	436.3	0	69.7	51	142.5	32	31.1	21.8	23.7	11	12.36
FS Financial WFSI	245.0	-15	518.2	-8	33.5	0	100.5	73	13.7	11.7	21.6	9	4.99
DIVERSIFIED FINANCIAL SERVICES													
DUSTRY COMPOSITE	40304.2	8	79684.7	8	884.5	-86	8399.2	-30	2.2	17.0	14.2	15	2.72
T Group CIT	1151.7	-1	2285.7	-2	176.6	29	365.9	39	15.3	11.8	11.8	11	3.11
tigroup C	27287.0**	14	53263.0	13	1144.0	-73	6417.0	-24	4.2	18.0	15.7	15	3.04
stinet Group INGP	280.9**	-1	595.2	9	8.4	NM	27.3	NM	3.0	NM	-0.7	NM	-0.02
Morgan Chase JPM	11227.0	-5	22852.0	-2	-548.0	NM	1382.0	-57	NM	15.4	10.7	16	2.32
oody's MCO	357.6	14	688.8	17	103.5	3	207.0	7	28.9	32.3	379.6	26	2.48
INSURANCE													
DUSTRY GROUP COMPOSITE	86148.6	12	168947.3	14	10009.4	33	18918.2	37	11.6	9.8	12.3	15	3.45
CE ACE	3067.0	17	5962.0	23	413.0	11	860.0	39	13.5	14.1	17.2	7	5.69
FLAC AFL	3233.0	13	6513.0	15	265.0	7	581.0	20	8.2	8.7	14.4	23	1.71
llstate ALL	8304.0	5	16615.0	5	1034.0	76	2158.0	72	12.5	7.4	16.8	9	5.13
mbac Financial Group ABK	351.6**	10	688.6	13	180.9	11	352.7	17	51.5	50.9	15.2	12	6.17
merican Financial Group AFG	896.2	19	1729.4	6	56.3	88	130.7	139	6.3	4.0	18.9	5	5.41
merican International Group AIG	21719.7**	21	43424.0	24	2862.3	26	5517.9	30	13.2	12.7	14.6	17	4.21
merican National Insurance ANAT	777.7	23	1503.2	20	64.2	149	128.9	96	8.2	4.1	7.9	10	9.25
erkley (W.R.) BER	1110.8	20	2189.5	27	109.5	14	225.6	35	9.9	10.3	21.8	9	4.51
hubb CB	3173.5	13	6304.1	17	356.1	41	716.8	50	11.2	9.0	11.6	13	5.48
incinnati Financial CINF	922.6	16	1793.1	19	155.3	84	301.4	114	16.8	10.6	8.8	13	3.14
NA Financial CNA	2663.0	-14	4928.0	-17	289.0	313	164.0	7	10.9	2.3	-20.0	NM	-6.75
ommerce Group CGI	430.9	-3	881.8	9	37.4	-48	88.4	5	8.7	16.0	17.2	9	5.06
elphi Financial Group DFG	257.7	13	516.2	16	27.1	10	57.8	22	10.5	10.8	13.1	12	3.37
verest Re Group RE	1264.1	33	2382.9	34	264.0	141	390.1	91	20.9	11.5	18.2	7	10.78
idelity National Financial FNF	2204.2	10	4041.1	17	222.1	-11	372.3	-4	10.1	12.4	19.0	7	5.09
rst American FAF	1724.1**	12	3197.8	11	116.5	-9	171.5	-20	6.8	8.3	20.5	6	4.59
enworth Financial GNW	2925.0	2	5946.0	4	268.0	1	528.0	2	9.2	9.3	5.6	NA	NA
reat American Financial Resources GFR	246.4	7	482.6	6	15.0	114	34.2	124	6.1	3.0	6.6	10	1.49
nfinity Property & Casualty IPCC	238.4	32	468.6	30	24.8	102	41.8	76	10.4	6.8	15.8	8	3.66
efferson-Pilot JP	1047.2	14	2032.0	14	142.0	1	270.4	8	13.6	15.3	13.3	13	3.62
incoln National LNC	1358.7	12	2617.7	13	187.2	31	317.5	72	13.8	11.8	15.1	9	4.99
oews LTR	3745.0**	-8	7080.0	-10	407.3	90	450.9	11	10.9	5.3	-5.6	NM	-4.08
Marsh & McLennan MMC	3036.0	6	6246.0	9	389.0	7	835.0	3	12.8	12.7	28.1	15	2.90
MetLife MET	9690.0**	9	19191.0	11	747.0	31	1405.0	62	7.7	6.5	11.7	11	3.27
Progressive PGR	3364.5	15	6641.5	18	386.3	35	846.3	46	11.5	9.8	27.5	11	6.93
Safeco SAFC	1555.8	16	3054.1	16	248.9	271	434.5	196	16.0	5.0	10.3	11	4.08
StanCorp Financial Group SFG	525.5	1	1050.0	2	52.5	41	96.1	38	10.0	7.1	14.5	11	6.25
State Auto Financial STFC	273.1	4	546.2	6	34.6	317	67.0	128	12.7	3.2	17.3	12	2.49
Stewart Information Services STC	565.5**	1	1030.3	3	30.0	-27	41.1	-33	5.3	7.4	15.8	6	5.75
Torchmark TMK	764.0	4	1536.5	6	116.6	6	228.9	9	15.3	14.9	13.4	13	3.94
Transatlantic Holdings TRH	970.6	17	1943.0	22	87.8	17	177.5	29	9.0	9.0	14.1	11	5.19
21st Century Insurance Group TW	342.7	7	681.7	12	21.4	-27	41.2	84	6.2	9.1	10.2	15	0.85
XL Capital XL †	3152.5	70	5239.2	45	373.7	4	835.9	38	11.9	19.3	8.1	17	4.30
Zenith National Insurance ZNT	247.8	17	491.2	24	24.8	35	49.9	66	10.0	8.7	20.4	11	3.87
3 REAL ESTATE													
NDUSTRY GROUP COMPOSITE	2974.5	14	5860.1	16	287.9	16	588.8	22	9.7	9.5	7.2	35	0.95
Boston Properties BXP	346.0	7	681.0	6	67.5	8	130.0	-24	19.5	19.3	8.7	22	2.41
Forest City Enterprises FCE.A (11) †	288.6	25	557.2	18	6.8	-54	0.9	-97	2.4	6.4	4.1	87	0.61
Host Marriott HMT	927.0	12	1730.0	8	-3.0	NM	-36.0	NM	NM	NM	-12.0	NM	-0.81
Plum Creek Timber PCL	341.0	7	838.0	42	57.0	-2	212.0	133	16.7	18.2	14.2	18	1.70
Simon Property Group SPG †	621.4	7	1221.8	7	79.2	-3	135.2	-7	12.7	14.0	9.9	34	1.49
St. Joe JOE	232.5	28	414.0	26	22.6	131	35.4	48	9.7	5.4	17.9	38	1.13
Thornburg Mortgage TMA	218.0	56	418.1	59	57.9	37	111.3	37	26.6	30.1	13.3	10	2.78

COMPANY (TICKER)	SALES 2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	PROFITS 2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	MARGINS 2ND QUARTER 2004 %	2ND QUARTER 2003 %	[illegible]	PRICE/EARNINGS RATIO 7-29	[illegible]
HEALTH CARE													
SECTOR COMPOSITE	178032.6	17	346594.2	17	16587.5	122	32594.6	43	9.3	4.9	17.0	24	1.68
14 HEALTH-CARE EQUIPMENT & SERVICES													
INDUSTRY GROUP COMPOSITE	120684.8	18	233469.9	16	5442.4	30	10937.4	24	4.5	4.1	16.4	22	2.05
(A) HEALTH-CARE EQUIPMENT & SUPPLIES													
INDUSTRY COMPOSITE	15329.7	19	29466.5	18	1813.2	30	3660.4	19	11.8	10.8	18.1	31	1.46
Bard (C.R.) BCR	416.3	18	810.1	17	58.7	19	130.6	35	14.1	14.0	17.7	28	1.91
Bausch & Lomb BOL	566.5	11	1076.8	12	41.4	46	64.9	45	7.3	5.5	11.7	22	2.71
Baxter International BAX	2379.0	10	4588.0	10	-169.0	NM	20.0	-92	NM	2.3	20.2	27	1.12
Beckman Coulter BEC	597.3	8	1134.1	11	58.3	12	93.9	-3	9.8	9.5	21.5	18	3.11
Becton, Dickinson BDX (3)	1257.8	8	2528.3	10	109.4	-16	274.6	1	8.7	11.2	17.9	22	2.12
Biomet BMET (7)	447.2	19	857.4	17	79.9	3	166.5	11	17.9	20.6	22.5	34	1.27
Boston Scientific BSX	1460.0	71	2542.0	53	313.0	175	507.0	140	21.4	13.3	20.7	42	0.90
Dentsply International XRAY	425.3	8	840.7	10	49.2	13	95.0	17	11.6	11.0	14.6	22	2.26
Edwards Lifesciences EW	234.6	8	469.6	9	25.5	21	-36.6	NM	10.9	9.7	1.2	NM	0.10
Guidant GDT	938.8	1	1872.9	5	135.6	NM	288.6	287	14.4	NM	20.2	27	2.00
Invacare IVC	339.3	13	660.6	15	18.0	17	32.2	16	5.3	5.1	11.8	17	2.37
Medtronic MDT (6)	2665.4	24	4859.2	20	568.9	17	1032.8	13	21.3	22.7	21.6	31	1.60
Millipore MIL	224.7	14	447.1	16	28.5	28	55.7	28	12.7	11.3	21.1	23	2.27
St. Jude Medical STJ	556.6	12	1105.2	18	98.8	23	194.0	21	17.8	16.2	19.3	33	2.02
Steris STE (9)	254.8	-2	550.9	3	17.6	7	47.9	11	6.9	6.4	14.2	15	1.35
Stryker SYK	1043.0	17	2078.1	20	152.7	42	288.6	36	14.6	12.1	21.5	36	1.30
Thermo Electron TMO	525.3	12	1050.3	14	50.6	-7	90.2	2	9.6	11.7	7.4	24	1.07
Waters WAT	260.5	12	515.6	14	59.8	42	100.6	32	22.9	18.2	35.4	28	1.57
Zimmer Holdings ZMH	737.4	79	1479.6	85	116.3	31	213.9	26	15.8	21.6	9.6	51	1.45
(B) HEALTH-CARE PROVIDERS & SERVICES													
INDUSTRY COMPOSITE	105355.1	18	204003.4	16	3629.2	31	7277.1	27	3.4	3.1	15.5	16	2.67
Aetna AET	4875.0**	9	9696.3	9	286.3	107	612.1	31	5.9	3.1	13.2	13	6.74
AmerisourceBergen ABC (3)	13071.6	5	26435.2	8	125.8	12	267.9	17	1.0	0.9	11.3	13	4.29
Anthem ATH	4604.5	12	9178.6	12	237.9	34	533.5	45	5.2	4.3	14.3	12	6.59
Caremark Rx CMX	7304.4	231	10330.4	137	139.2	103	223.4	70	1.9	3.1	5.1	25	1.19
Centene CNC	233.6	25	459.1	26	10.8	40	21.0	41	4.6	4.1	16.2	21	1.86
Cerner CERN	228.4	10	447.1	10	14.3	60	28.4	96	6.3	4.3	10.6	29	1.53
Community Health Systems CYH	813.7	24	1636.0	24	38.4	26	79.2	23	4.7	4.7	10.1	17	1.43
Covance CVD	258.6	7	510.1	5	23.3	28	45.5	26	9.0	7.5	14.3	27	1.33
Coventry Health Care CVH	1310.0	19	2598.0	20	84.0	32	158.3	40	6.4	5.8	29.5	16	3.25
Express Scripts ESRX	3779.5	13	7407.3	13	65.4	11	135.4	14	1.7	1.8	20.3	19	3.39
HCA HCA	5833.0	7	11770.0	10	352.0	47	697.0	-2	6.0	4.4	20.8	14	2.65
Health Management Associates HMA (3)	817.3	26	1651.2	28	89.3	18	179.8	17	10.9	11.7	16.8	15	1.30
Humana HUM	3415.5**	13	6702.4	13	80.8	17	148.6	48	2.4	2.3	14.5	11	1.70
IMS Health RX	379.6	12	741.2	14	65.1	18	146.2	NM	17.2	16.4	173.8	21	1.18
Laboratory Corp. of America Holdings LH	784.3	5	1536.8	6	98.3	14	185.6	16	12.5	11.6	18.0	16	2.42
LifePoint Hospitals LPNT	246.4	11	503.0	14	18.7	22	42.6	29	7.6	6.9	17.2	17	2.00
Lincare Holdings LNCR	315.4	11	622.3	13	67.4	19	130.3	19	21.4	20.1	25.5	13	2.48
Manor Care HCR	799.1	6	1596.5	8	40.1	112	81.2	62	5.0	2.5	15.4	19	1.68
McKesson MCK (9)	19186.6	16	37126.5	18	163.6	5	377.8	12	0.9	0.9	12.1	14	2.22
Medco Health Solutions MHS	8836.2	5	17742.1	6	127.3	21	230.8	11	1.4	1.3	8.3	18	1.64
Omnicare OCR	1010.6	20	1992.9	21	60.5	39	123.9	48	6.0	5.2	12.9	13	2.25
Owens & Minor OMI	1119.4	6	2225.4	7	15.3	13	30.0	13	1.4	1.3	13.1	18	1.46
PacifiCare Health Systems PHS	3047.4	12	6011.6	10	76.0	4	143.0	-1	2.5	2.7	12.3	12	2.73
Patterson Companies PDCO (8)	537.4	20	1058.6	22	45.1	34	85.2	34	8.4	7.5	18.6	34	2.17
Priority Healthcare PHCC	438.5	25	839.7	20	12.2	7	24.4	-1	2.8	3.3	13.7	20	1.16
Quest Diagnostics DGX	1297.7	6	2553.4	10	126.9	5	243.0	17	9.8	9.9	19.3	18	4.44
Renal Care Group RCI	340.9	38	618.9	27	29.2	13	59.3	25	8.6	10.4	22.2	20	1.57
Schein (Henry) HSIC	945.7	22	1832.3	21	38.7	18	67.1	17	4.1	4.2	14.2	20	3.31
Select Medical SEM	418.7	28	840.7	32	31.0	66	60.5	83	7.4	5.7	22.7	14	0.95
Sierra Health Services SIE	441.2**	19	849.4	18	38.2	86	64.5	80	8.7	5.5	66.2	13	3.37
Triad Hospitals TRI	1092.5	22	2198.3	23	-4.9	NM	43.9	-47	NM	4.2	2.7	45	0.76
UnitedHealth Group UNH	8704.0**	23	16848.0	20	596.0	36	1150.0	37	6.8	6.2	30.0	19	3.41
Universal Health Services UHS	1018.7**	16	2038.6	16	47.1	-10	93.2	-12	4.6	5.9	16.0	15	3.04
US Oncology USON	565.2	15	1090.2	16	24.5	39	44.7	32	4.3	3.6	12.7	16	0.91
WellChoice WC	1504.1**	9	2888.6	8	65.4	34	124.6	29	4.3	3.5	14.8	13	2.74
WellPoint Health Networks WLP	5780.4**	17	11426.6	17	299.9	34	595.2	43	5.2	4.5	17.9	14	7.07
15 PHARMACEUTICALS & BIOTECHNOLOGY													
INDUSTRY GROUP COMPOSITE	57347.7	15	113124.4	17	11145.1	238	21657.2	55	19.4	6.6	17.4	26	1.52
(A) BIOTECHNOLOGY													
INDUSTRY COMPOSITE	5880.9	38	11272.2	39	1090.2	8	2067.1	11	18.5	23.6	6.6	59	0.87
Amgen AMGN	2584.9	27	4927.9	30	748.1	23	1438.3	31	28.9	29.7	13.4	29	1.96

	SALES				PROFITS				MARGINS				
	2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL	CHANGE FROM 2003 %	2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL	CHANGE FROM 2003 %	2ND QUARTER 2004 %	2ND QUARTER 2003 %	RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE EARNINGS RATIO 7-29	12 MONTHS' EARNINGS PER SHARE
lied Biosystems Group ABI [6]	460.5	6	900.1	7	40.5	-58	86.5	-36	8.8	22.2	13.0	25	0.83
gen Idec BIIB	538.8	336	1080.5	349	0.8	-97	-40.4	NM	0.2	23.3	-14.2	NM	-3.89
ron CHIR †	365.1	13	714.4	16	32.1	-48	59.0	-52	8.8	19.0	6.3	58	0.79
entech DNA	1128.1	41	2103.2	36	170.8	29	347.4	22	15.1	16.5	9.8	76	0.64
zyme General GENZ	549.6	58	1040.8	57	78.2	25	146.1	21	14.2	18.1	3.4	NM	0.45
trogen IVGN	254.0	32	505.3	35	19.7	16	30.2	-11	7.8	8.8	3.0	49	1.06
PHARMACEUTICALS													
USTRY COMPOSITE	51466.9	13	101852.1	15	10055.0	338	19590.1	62	19.5	5.0	20.1	23	1.62
ott Laboratories ABT	4703.0	14	9343.9	15	634.9	254	1397.2	53	13.5	4.3	23.0	20	1.97
rgan AGN	506.2	15	978.6	18	91.8	NM	172.6	NM	18.1	NM	16.7	64	1.16
tol-Myers Squibb BMY	5430.0	6	10611.0	8	527.0	-42	1491.0	-12	9.7	17.6	28.1	15	1.49
st Laboratories FRX [9]	782.4	29	1507.5	23	229.9	28	375.4	4	29.4	29.7	24.1	24	2.07
nson & Johnson JNJ	11484.0	11	23043.0	14	2458.0	103	4951.0	51	21.4	11.7	31.1	19	2.96
(Eli) LLY	3556.3	15	6933.2	16	656.9	-5	1057.3	-4	18.5	22.4	24.0	27	2.32
ck MRK	6021.7	9	11652.6	5	1768.1	-1	3386.7	2	29.4	32.3	40.9	15	2.97
an Laboratories MYL [9]	339.0	2	672.4	-2	82.0	-2	156.9	-1	24.2	25.3	19.2	12	1.21
er PFE	12274.0	24	24762.0	35	2844.0	NM	5163.0	NM	23.2	NM	11.6	30	1.05
ering-Plough SGP	2147.0	-7	4110.0	-6	-65.0	NM	-138.0	NM	NM	7.9	-8.2	NM	-0.39
eth WYE	4223.2	13	8238.0	11	827.3	-4	1577.0	-26	19.6	23.1	15.3	32	1.11
DUSTRIALS													
TOR COMPOSITE	263283.0	15	502127.5	14	14767.5	7	26291.6	18	5.6	6.0	13.9	23	1.74
CAPITAL GOODS													
USTRY GROUP COMPOSITE	176493.7	15	336459.8	15	12088.4	32	21649.9	38	6.8	5.9	15.5	21	2.05
AEROSPACE & DEFENSE													
USTRY COMPOSITE	60397.3	13	118213.4	15	2889.4	57	5541.4	82	4.8	3.5	14.1	20	2.64
all AVL	314.0	25	597.6	19	13.5	NM	23.4	631	4.3	NM	12.5	16	1.23
ing BA	13088.0	3	25991.0	4	586.0	NM	1200.0	NM	4.5	NM	29.0	16	3.20
neral Dynamics GD	4761.0	21	9521.0	29	296.0	22	565.0	22	6.2	6.2	17.0	18	5.50
odrich GR	1134.0	4	2296.1	5	38.8	164	69.4	NM	3.4	1.3	10.0	31	1.06
xcel HXL	272.2	16	535.0	16	8.8	83	16.9	956	3.2	2.1	NM	NM	-0.30
neywell International HON	6388.0	11	12566.0	13	361.0	13	656.0	11	5.7	5.5	12.9	23	1.63
Communications Holdings LLL	1680.0	37	3201.4	38	88.1	65	160.1	55	5.2	4.4	10.8	19	3.15
kheed Martin LMT	8776.0	14	17123.0	16	296.0	22	587.0	19	3.4	3.1	16.3	21	2.56
rthrop Grumman NOC	7374.0	11	14479.0	16	289.0	40	517.0	36	3.9	3.1	6.0	20	2.58
ecision Castparts PCP [9]	738.8	55	1443.9	47	52.4	48	93.9	27	7.1	7.4	8.9	23	2.49
ytheon RTN	4929.0	11	9605.0	11	-94.0	NM	7.0	-98	NM	4.2	2.5	57	0.59
ckwell Collins COL [3]	744.0	20	1463.0	18	76.0	-1	147.0	8	10.2	12.4	30.7	22	1.59
ted Defense Industries UDI	576.3	4	1123.4	10	40.8	13	82.7	11	7.1	6.5	85.6	12	2.80
ited Technologies UTX	9622.0**	24	18268.0	26	837.0	32	1416.0	25	8.7	8.1	21.1	18	5.22
BUILDING PRODUCTS													
DUSTRY COMPOSITE	5939.3	18	10764.7	16	305.5	50	454.3	60	5.1	4.1	25.4	15	2.29
nerican Standard ASD	2575.3	14	4760.3	13	159.7	19	244.3	24	6.2	5.9	57.6	19	2.03
l Building Systems NCS [2]	254.7	28	470.1	15	7.7	281	13.5	130	3.0	1.0	8.4	20	1.57
iversal Forest Products UFPI	742.6	34	1208.2	33	19.8	15	25.3	17	2.7	3.1	13.2	13	2.35
-G USG	1145.0	25	2165.0	22	80.0	158	137.0	158	7.0	3.4	27.0	3	5.14
rk International YRK	1221.7	13	2161.1	11	38.4	100	34.2	514	3.1	1.8	5.0	37	0.95
CONSTRUCTION & ENGINEERING													
DUSTRY COMPOSITE	6529.1	4	12480.3	2	117.1	10	232.0	30	1.8	1.7	8.4	22	1.48
com Industries DY [5]	219.6	57	415.9	50	11.2	301	27.6	NM	5.1	2.0	10.6	25	1.09
cor Group EME	1193.2	4	2302.3	4	1.4	-83	7.2	-38	0.1	0.7	3.1	41	1.05
ior FLR	2214.4	-1	4277.7	-1	44.8	4	91.5	9	2.0	1.9	16.0	20	2.29
cobs Engineering Group JEC [3]	1119.5	-1	2243.4	-4	29.9	-9	64.7	1	2.7	2.9	13.8	17	2.31
aw Group SGR [4]	917.8	12	1604.6	4	10.0	175	12.7	NM	1.1	0.4	-3.2	NM	-0.42
S URS [2]	864.7	6	1636.4	4	19.7	27	28.3	32	2.3	1.9	6.3	13	1.87
ELECTRICAL EQUIPMENT													
DUSTRY COMPOSITE	5632.7	12	10935.1	12	368.1	10	662.3	21	6.5	6.7	13.7	21	1.56
uity Brands AYI [4]	532.2	2	1023.3	1	18.0	18	27.5	20	3.4	2.9	12.3	18	1.28
nerican Power Conversion APCC	395.7	19	747.4	17	26.8	-19	61.4	-3	6.8	10.0	11.3	20	0.86
netek AME	303.9	10	595.3	9	27.7	27	52.3	26	9.1	7.9	16.9	21	1.44
ooper Industries CBE	1109.3	10	2173.9	10	83.9	16	161.6	25	7.6	7.2	14.6	18	3.23
eneral Cable BGC	517.5	30	996.1	33	5.2	73	3.3	6	1.0	0.8	-6.3	NM	-0.24
enlyte Group GLYT	301.4	19	578.8	18	11.5	17	22.4	20	3.8	3.9	13.1	17	3.65
ubbell HUB.B	502.9	12	968.1	11	31.4	30	65.4	42	6.2	5.4	15.5	21	2.21
ockwell Automation ROK [3]	1163.5	13	2276.4	10	126.4	-1	204.7	16	10.9	12.4	19.4	22	1.70
nith (A.O.) AOS	437.3	5	853.8	6	17.3	-13	28.0	-16	4.0	4.7	7.8	18	1.56
homas & Betts TNB	369.0	14	722.0	14	20.0	196	35.6	203	5.4	2.1	8.7	23	1.13

COMPANY SYMBOL	SALES 2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	SALES 6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	PROFITS 2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	PROFITS 6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	MARGINS 2ND QUARTER 2004 %	MARGINS 2ND QUARTER 2003 %	RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-[illegible]	PRICE EARNINGS RATIO 7-29	[illegible]
(E) INDUSTRIAL CONGLOMERATES													
INDUSTRY COMPOSITE	46576.0	10	89225.4	10	4916.7	7	9021.1	6	10.6	10.9	16.7	22	1.6
Allete ALE	416.0	4	846.0	4	32.9	-11	86.0	15	7.9	9.3	9.6	15	1.8
Carlisle CSL	640.7	17	1194.1	18	39.2	36	64.2	40	6.1	5.3	15.7	19	3.
General Electric GE	36711.0**	10	69924.0	10	3924.0	3	7164.0	2	10.7	11.4	16.0	22	1.5
Teleflex TFX	653.4	13	1291.4	15	34.2	7	63.6	4	5.2	5.5	10.0	16	2.
Textron TXT	2547.0**	1	4901.0	-1	100.0	18	137.0	-9	3.9	3.4	7.3	32	1.9
3M MMM	5012.0	9	9951.0	12	773.0	25	1495.0	33	15.4	13.5	32.8	24	3.
Tredegar TG	216.1	19	412.0	13	5.2	208	7.6	16	2.4	0.9	4.6	30	0.5
Walter Industries WLT	379.9	7	705.9	7	8.3	-51	3.7	-84	2.2	4.8	-8.6	NM	-0.
(F) MACHINERY													
INDUSTRY COMPOSITE	47954.6	25	88315.9	24	3310.2	74	5429.6	82	6.9	5.0	15.8	20	2.6
AGCO AG	1407.0	56	2522.7	52	48.3	210	73.3	161	3.4	1.7	9.6	14	1.
Albany International AIN	227.2	-1	458.5	3	-15.4	NM	-12.1	NM	NM	7.0	1.0	NM	0.1
Barnes Group B	252.0	10	499.2	11	11.3	16	20.9	22	4.5	4.2	10.9	17	1.5
Caterpillar CAT	7564.0	28	14031.0	30	552.0	38	964.0	83	7.3	6.7	23.2	17	4.3
Crane CR	479.1	18	927.4	19	31.2	20	53.4	26	6.5	6.4	14.6	14	1.
Cummins CMI	2124.0	38	3895.0	33	82.0	486	115.0	NM	3.9	0.9	16.5	17	4.2
Danaher DHR	1621.2	25	3164.4	27	182.2	46	327.5	43	11.2	9.6	16.0	26	1.9
Deere DE (2)	5877.0**	34	9360.8	30	477.3	86	648.1	99	8.1	5.8	20.4	16	3.8
Donaldson DCI (5)	370.6	23	702.8	20	29.6	17	54.6	20	8.0	8.4	20.6	23	1.1
Dover DOV	1380.4	26	2622.7	25	109.7	53	193.5	50	7.9	6.5	12.2	23	1.7
Eaton ETN	2403.0	19	4641.0	17	161.0	73	295.0	79	6.7	4.6	16.2	20	3.2
Federal Signal FSS	304.1	-2	580.7	-4	-2.3	NM	-0.1	NM	NM	3.2	5.2	38	0.4
Greenbrier GBX (4)	225.3	63	391.9	53	6.4	112	8.6	387	2.8	2.2	11.4	24	0.9
Harsco HSC	617.6	15	1173.9	15	31.0	22	47.8	26	5.0	4.7	12.1	19	2.3
IDEX IEX	233.6	13	448.2	11	22.8	35	40.5	37	9.8	8.2	11.5	22	1.4
Illinois Tool Works ITW	3002.3	17	5712.6	17	360.4	27	650.4	35	12.0	11.1	14.7	23	3.8
Ingersoll-Rand IR	2713.9	12	5005.9	10	250.4	72	415.4	76	9.2	6.0	16.1	16	4.3
ITT Industries ITT	1652.5	15	3168.4	16	112.7	22	200.8	12	6.8	6.4	21.4	18	4.3
JLG Industries JLG (5)	318.7	55	555.2	55	8.7	301	10.8	70	2.7	1.1	6.5	36	0.3
Joy Global JOYG (2)	337.7	13	621.4	15	18.8	686	19.8	NM	5.6	0.8	10.0	37	0.8
Kennametal KMT (6)	541.9	17	1066.1	16	29.9	NM	53.9	NM	5.5	NM	8.3	21	2.0
Lincoln Electric Holdings LECO	331.8	25	638.3	24	23.7	67	42.0	59	7.1	5.4	13.6	20	1.7
Mueller Industries MLI	380.8**	53	726.8	51	27.0	201	45.0	235	7.1	3.6	8.8	19	2.0
Navistar International NAV (2)	2331.0	25	4190.0	22	41.0	NM	18.0	NM	1.8	NM	31.3	24	1.5
Oshkosh Truck OSK (3)	599.8	11	1118.0	13	30.6	26	53.1	39	5.1	4.5	18.0	17	3.0
Paccar PCAR	2786.8	38	5288.1	35	236.5	91	418.7	78	8.5	6.2	20.5	15	4.0
Pall PLL (5)	463.9	10	892.0	10	46.5	15	71.4	-1	10.0	9.6	14.6	19	1.2
Parker Hannifin PH (6)	1992.9	20	3899.0	18	125.5	156	233.3	139	6.3	3.0	11.6	20	2.9
Pentair PNR	813.9	13	1581.0	17	55.5	26	95.7	33	6.8	6.1	12.5	19	1.6
Reliance Steel & Aluminum RS	760.8	67	1416.5	56	52.8	726	82.6	590	6.9	1.4	14.3	12	3.2
Stewart & Stevenson Services SVC (11)	304.3	5	587.2	1	5.5	232	-36.2	NM	1.8	0.6	-16.1	NM	-1.7
Terex TEX	1336.4	27	2380.2	20	59.1	NM	76.1	NM	4.4	NM	9.5	22	1.7
Timken TKR	1130.3	14	2229.1	22	25.3	546	53.8	253	2.2	0.4	6.7	29	0.8
Toro TTC (2)	548.0**	11	861.6	9	52.2	24	61.5	26	9.5	8.5	19.3	18	3.6
Valmont Industries VMI	266.0	33	481.9	18	2.8	-56	8.3	-39	1.1	3.2	7.6	26	0.8
Wabash National WNC	254.9	11	476.5	5	18.3	NM	25.1	NM	7.2	NM	-13.3	NM	-0.4
(G) TRADING COMPANIES & DISTRIBUTORS													
INDUSTRY COMPOSITE	3464.7	16	6525.0	14	181.3	54	309.3	48	5.2	3.9	12.3	26	1.8
Fastenal FAST	310.1	24	594.3	23	34.8	59	63.0	54	11.2	8.8	16.9	45	1.4
Grainger (W.W.) GWW	1256.0	7	2483.8	7	66.6	19	129.2	19	5.3	4.8	13.3	20	2.7
Hughes Supply HUG (11)	992.8	27	1788.8	21	29.8	153	39.2	104	3.0	1.5	7.3	21	2.9
Huttig Building Products HBP	277.8	23	520.9	23	6.8	325	9.5	NM	2.4	0.7	20.0	10	0.8
MSC Industrial Direct MSM (4)	255.3	18	485.8	14	23.9	81	42.4	64	9.4	6.1	12.6	30	1.0
Watsco WSO	372.6	9	651.4	9	19.4	44	26.0	51	5.2	3.9	11.3	17	1.6
17 COMMERCIAL SERVICES & SUPPLIES													
INDUSTRY GROUP COMPOSITE	29446.0	13	55280.8	12	2215.9	28	3469.0	22	7.5	6.6	15.1	26	1.2
ABM Industries ABM (2)	590.3**	5	1161.2	4	6.8	-27	13.9	7	1.1	1.6	8.2	24	0.7
Allied Waste Industries AW	1362.3	1	2637.1	2	-9.4	NM	-4.4	NM	NM	1.4	-0.4	NM	-2.2
Apollo Group APOL (4)	497.0	36	893.9	36	109.3	47	177.8	48	22.0	20.4	25.7	49	1.7
Avery Dennison AVY	1324.0	11	2570.7	10	68.5	-2	121.1	-12	5.2	5.8	16.4	27	2.2
Banta BN	367.6	9	740.7	10	15.2	110	29.3	58	4.1	2.2	11.7	18	2.2
Block (H&R) HRB (8)	2191.8	15	3151.3	10	575.6	16	682.4	9	26.3	25.9	37.1	13	3.9
Career Education CECO	409.4	60	812.1	62	39.7	103	81.5	110	9.7	7.7	18.0	22	1.5
CDI CDI	264.8	-2	520.8	-3	5.2	-15	10.1	-12	2.0	2.3	6.9	27	1.0
Cendant CD	5209.0	13	9518.0	11	493.0	28	870.0	36	9.5	8.4	15.4	15	1.5
ChoicePoint CPS	231.4	16	448.6	14	36.3	74	69.6	33	15.7	10.5	14.1	30	1.3

	SALES				PROFITS				MARGINS				
	2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL	CHANGE FROM 2003 %	2ND QUARTER 2004 %	2ND QUARTER 2003 %	RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE EARNINGS RATIO 7-29	12 MONTHS EARNINGS PER SHARE
as CTAS (7)	738.2	9	1435.1	7	72.7	12	139.2	12	9.9	9.6	14.4	27	1.58
ixe DLX	309.4	0	618.2	-1	46.0	2	93.6	-1	14.9	14.5	NM	12	3.71
& Bradstreet DNB	349.9	4	693.3	7	39.5	13	89.3	24	11.3	10.5	401.7	22	2.56
ifax EFX	318.9	1	632.5	2	73.2	48	124.4	32	23.0	15.6	49.0	16	1.55
HNI	508.6	25	972.6	22	25.8	28	48.2	34	5.1	5.0	15.5	21	1.88
y Services KELYA	1224.5	16	2383.3	16	5.0	240	6.1	241	0.4	0.1	1.5	NM	0.26
or Ready LRW	267.1	24	476.0	23	10.1	94	10.9	441	3.8	2.4	15.4	25	0.58
power MAN	3622.4	20	6956.5	22	53.1	82	92.7	111	1.5	1.0	9.7	20	2.20
er (Herman) MLHR (7)	353.8	10	683.4	8	19.8	NM	27.6	NM	5.6	NM	22.0	44	0.59
ey Bowes PBI	1205.9	6	2377.8	7	134.7	13	261.3	12	11.2	10.5	46.1	19	2.24
ert Half International RHI	641.2	33	1213.5	27	32.4	NM	47.9	NM	5.1	0.0	6.9	85	0.33
erion SFN	496.3	17	974.8	16	3.2	NM	-0.8	NM	0.6	NM	-1.0	NM	-0.05
ndard Register SR	226.5	-3	452.5	-4	-2.6	NM	-9.1	NM	NM	NM	-14.9	NM	-1.23
elcase SCS (10)	597.7	8	1161.1	-2	-6.7	NM	-20.6	NM	NM	NM	-2.8	NM	-0.23
a Tech TTEK (3)	263.2	14	506.0	19	9.0	-35	22.1	-13	3.4	6.0	12.8	18	0.89
ed Rentals URI	776.0	7	1420.8	8	35.0	50	-71.6	NM	4.5	3.2	-33.0	NM	-4.55
ted Stationers USTR	966.7	1	1954.5	1	21.0	39	44.4	31	2.2	1.6	13.0	15	2.64
versity of Phoenix Online UOPX (4)	233.3	60	417.3	59	57.1	80	95.1	76	24.5	21.7	40.8	61	1.43
Information Sciences VOL (2)	477.2	18	889.9	18	4.3	NM	2.7	NM	0.9	NM	4.6	38	0.77
te Management WMI	3138.0	7	6034.0	6	216.0	23	360.0	27	6.9	6.0	13.8	21	1.36
WSTC	283.7	19	573.1	26	26.8	28	54.2	32	9.4	8.8	14.2	17	1.47
TRANSPORTATION													
USTRY GROUP COMPOSITE	57343.2	14	110386.9	13	463.2	-84	1172.7	-69	0.8	5.9	6.9	41	0.95
AIR FREIGHT & LOGISTICS													
USTRY COMPOSITE	20727.7	13	40162.1	11	1413.1	31	2505.4	31	6.8	5.9	17.1	26	2.63
F CNF	1441.7	17	2790.1	14	37.5	104	63.9	76	2.6	1.5	14.1	20	2.04
Ex FDX (7)	7041.0	21	13103.0	15	412.0	47	619.0	45	5.9	4.8	10.4	30	2.76
Group HUBG	349.0	5	677.3	2	4.1	162	6.8	133	1.2	0.5	8.1	22	1.51
nt (J.B.) Transport Services JBHT	679.0	13	1296.7	11	45.6	82	78.6	116	6.7	4.2	17.6	23	1.67
inson (C.H.) Worldwide CHRW	1077.1	15	2023.7	16	32.3	19	61.4	17	3.0	2.9	21.2	32	1.39
ler System R	1268.9	6	2481.2	4	63.6	83	98.7	78	5.0	2.9	12.8	16	2.74
ted Parcel Service UPS	8871.0	8	17790.0	10	818.0	18	1577.0	21	9.2	8.4	21.2	26	2.79
AIRLINES													
USTRY COMPOSITE	20625.3	14	39256.1	12	-1900.4	NM	-2919.7	NM	NM	5.2	-85.6	NM	-1.67
Tran Holdings AAI	275.0	18	516.4	17	16.8	-71	20.9	-65	6.1	24.5	20.2	16	0.71
ska Air Group ALK	698.7	14	1297.1	15	-1.7	NM	-44.4	NM	NM	7.4	-3.1	NM	-0.73
erica West Holdings AWA	605.1	5	1181.6	8	5.7	-93	6.9	-61	0.9	13.8	31.7	7	0.86
IR AMR	4830.0	12	9342.0	11	6.0	NM	-160.0	NM	0.1	NM	NM	NM	-1.70
ntinental Airlines CAL	2514.0	13	4783.0	12	-17.0	NM	-141.0	NM	NM	3.6	5.8	25	0.36
ta Air Lines DAL	3961.0	13	7490.0	10	-1963.0	NM	-2346.0	NM	NM	5.3	NM	NM	-23.00
pressJet Holdings XJT	370.8	16	734.9	17	29.7	10	58.4	11	8.0	8.4	234.4	5	2.07
tBlue Airways JBLU	319.7	31	608.7	32	21.5	-43	36.7	-34	6.7	15.5	11.6	32	0.76
sa Air Group MESA (3)	239.6	56	449.3	54	9.7	80	11.4	-30	4.0	3.5	22.2	9	0.68
rthwest Airlines NWAC	2871.0	18	5474.0	14	-175.0	NM	-398.0	NM	NM	9.4	NM	NM	-0.10
yWest SKYW	267.4	26	521.1	24	20.1	35	39.4	40	7.5	7.0	10.7	11	1.33
uthwest Airlines LUV	1716.0	13	3200.0	12	113.0	-54	139.0	-49	6.6	16.2	5.9	38	0.38
Airways Group UAIR	1957.0	10	3658.0	10	34.0	162	-143.0	NM	1.7	0.7	NM	NM	-6.14
MARINE													
DUSTRY COMPOSITE	377.1	20	720.8	23	29.2	56	56.0	92	7.7	6.0	11.3	15	2.26
exander & Baldwin ALEX	377.1**	20	720.8	23	29.2	56	56.0	92	7.7	6.0	11.3	15	2.26
ROAD & RAIL													
DUSTRY COMPOSITE	15613.1	16	30247.9	15	921.3	2	1531.1	11	5.9	6.7	7.4	19	1.81
kansas Best ABFS	424.5	10	799.3	6	19.3	27	23.8	64	4.5	3.9	13.4	16	2.19
rlington Northern Santa Fe BNI	2685.0	17	5175.0	14	249.0	25	442.0	27	9.3	8.7	9.8	15	2.34
X CSX	2033.0	5	3996.0	1	119.0	-6	149.0	-12	5.9	6.5	2.5	41	0.78
idlaw International LI (4)	1239.6	3	2402.1	3	34.6	-44	35.2	-55	2.8	5.2	3.5	30	0.46
ndstar System LSTR	482.3	24	903.3	20	17.6	30	25.7	8	3.6	3.5	32.2	30	1.70
rfolk Southern NSC	1813.0	11	3506.0	10	213.0	55	371.0	67	11.7	8.4	7.6	19	1.42
S Transportation SCST	248.2	19	473.5	16	5.5	40	8.1	54	2.2	1.9	8.9	22	1.17
vift Transportation SWFT	691.0	18	1313.4	16	34.6	80	41.0	46	5.0	3.3	11.3	19	1.09
S. Xpress Enterprises XPRSA	270.3	17	505.0	12	4.2	91	5.0	116	1.6	1.0	6.0	25	0.73
ion Pacific UNP	3029.0	5	5922.0	5	158.0	-43	323.0	-24	5.2	9.5	7.6	15	3.67
F USFC	611.9	8	1228.6	6	-2.0	NM	5.1	-59	NM	1.4	5.5	27	1.34
erner Enterprises WERN	411.1	13	797.4	12	21.6	9	37.2	17	5.3	5.5	10.9	21	0.97
low Roadway YELL	1674.1	135	3226.3	131	46.9	156	65.1	171	2.8	2.6	7.6	23	1.91

COMPANY SYMBOL	SALES 2ND QUARTER 2004 $ MIL	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL	CHANGE FROM 2003 %	PROFITS 2ND QUARTER 2004 $ MIL	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL	CHANGE FROM 2003 %	MARGINS 2ND QUARTER 2004 %	2ND QUARTER 2003 %	[illegible]	PRICE EARNINGS RATIO 7-29	[illegible]
INFORMATION TECHNOLOGY													
SECTOR COMPOSITE	197144.5	18	387570.2	17	17708.7	318	31585.9	181	9.0	2.5	12.1	32	0.68
19 SOFTWARE & SERVICES													
INDUSTRY GROUP COMPOSITE	42723.4	13	84075.2	13	6138.9	50	10579.8	26	14.4	10.9	12.0	34	0.70
(A) INTERNET SOFTWARE & SERVICES													
INDUSTRY COMPOSITE	1436.9	53	2775.4	50	184.1	NM	282.6	NM	12.8	NM	5.3	NM	0.2
EarthLink ELNK	348.6	-1	700.2	-1	49.7	NM	37.9	NM	14.2	NM	10.1	30	0.3
VeriSign VRSN	256.0	-3	485.2	-9	21.9	NM	31.0	NM	8.6	NM	-2.0	NM	-0.1
Yahoo YHOO	832.3	159	1590.1	163	112.5	121	213.7	119	13.5	15.8	7.1	NM	0.26
(B) IT SERVICES													
INDUSTRY COMPOSITE	22201.7	11	43629.6	11	1404.0	3	2904.9	11	6.3	6.8	13.2	25	1.1
Accenture ACN (4)	4050.2	18	7732.5	17	210.4	59	333.5	33	5.2	3.9	33.9	21	1.1
Acxiom ACXM (9)	289.0	22	566.8	19	12.9	14	28.8	NM	4.5	4.8	9.9	34	0.66
Affiliated Computer Services ACS (6)	1062.4	5	2071.9	4	96.5	15	196.3	20	9.1	8.3	20.6	14	3.
Alliance Data Systems ADS	300.5	20	612.9	25	28.0	99	60.4	129	9.3	5.6	13.7	32	1.22
Anteon International ANT	304.2	20	592.3	23	14.7	42	28.0	44	4.8	4.1	21.7	25	1.21
Automatic Data Processing ADP (6)	2085.8	9	4207.3	10	211.9	-2	512.1	-6	10.2	11.3	17.3	27	1.56
Certegy CEY	284.1	15	547.5	12	24.9	9	45.6	30	8.8	9.3	39.9	24	1.
Convergys CVG	601.7	7	1175.6	5	28.7	-33	61.2	-21	4.8	7.6	13.0	13	1.06
DST Systems DST	593.3	-4	1202.8	-3	51.8	-2	103.4	-1	8.7	8.6	41.3	14	3.18
Electronic Data Systems EDS	5238.0	3	10436.0	4	-132.0	NM	-170.0	NM	NM	1.4	-7.2	NM	-1.07
First Data FDC	2529.1**	22	4787.5	18	463.9	33	943.8	47	18.3	16.8	15.9	20	2.1
Fiserv FISV	946.0	31	1883.5	34	95.0	21	187.8	23	10.0	10.8	14.5	19	1.78
Gartner IT	227.9	7	436.5	5	11.0	-14	11.5	1	4.8	6.0	5.6	59	0.21
Keane KEA	231.7	14	447.5	10	8.1	22	13.6	-21	3.5	3.3	5.8	37	0.40
Paychex PAYX (7)	330.4	14	673.0	17	61.4	-14	141.9	-1	18.6	24.6	25.2	37	0.80
Sabre Holdings TSG	550.9	9	1090.7	4	58.9	766	102.0	42	10.7	1.3	6.9	32	0.81
SunGard Data Systems SDS	898.7	22	1739.4	23	102.6	14	188.2	13	11.4	12.2	13.4	18	1.33
Total System Services TSS	289.6	12	574.9	13	35.9	5	68.4	4	12.4	13.3	18.1	31	0.73
Unisys UIS	1388.1	-3	2851.0	1	19.4	-63	48.3	-47	1.4	3.7	14.5	16	0.64
(C) SOFTWARE													
INDUSTRY COMPOSITE	19084.7	14	37670.2	15	4550.7	60	7392.3	25	23.8	17.0	12.0	35	0.64
Adobe Systems ADBE (1)	410.1	28	833.4	35	109.4	70	232.4	96	26.7	20.1	30.1	27	1.55
Autodesk ADSK (11)	297.9	41	593.2	46	42.5	466	100.1	619	14.3	3.6	24.4	30	1.33
BEA Systems BEAS (11)	262.6	11	540.7	11	25.3	4	64.6	9	9.6	10.3	11.8	23	0.28
BMC Software BMC (9)	326.0	5	726.2	5	51.8	NM	88.7	512	15.9	NM	2.5	NM	0.13
Cadence Design Systems CDN	287.1	4	552.8	2	3.8	NM	-5.0	NM	1.3	NM	-0.3	NM	-0.01
Computer Associates International CA (9)	860.0	9	1710.0	10	53.0	563	82.0	NM	6.2	1.0	0.2	NM	0.01
Compuware CPWR (9)	287.1	-6	624.8	-3	0.6	-75	34.6	44	0.2	0.9	3.4	39	0.13
Electronic Arts ERTS (9)	431.6	22	1030.1	26	24.2	32	114.3	314	5.6	5.2	21.2	27	1.88
Intuit INTU (5)	713.0	12	1349.2	13	264.0	18	413.1	19	37.0	35.1	17.2	22	1.66
Microsoft MSFT (6)	9292.0	15	18467.0	16	2690.0	81	4005.0	10	29.0	18.4	10.9	38	0.75
Novell NOVL (2)	293.6	6	560.7	5	10.4	NM	20.5	NM	3.5	NM	-12.6	NM	-0.33
Oracle ORCL (7)	3076.0	9	5585.0	9	988.0	15	1623.0	14	32.1	30.3	33.5	21	0.50
PeopleSoft PSFT	647.3	30	1290.4	35	11.0	-70	35.2	-53	1.7	7.3	1.5	NM	0.13
Reynolds & Reynolds REY (3)	242.8	-3	492.3	-3	22.0	-16	48.4	-9	9.1	10.5	23.2	15	1.52
Siebel Systems SEBL	301.1	-10	630.3	-5	8.2	-16	39.9	177	2.7	2.9	1.0	NM	0.03
Symantec SYMC (9)	577.1	48	1133.5	45	131.2	123	248.1	95	22.7	15.0	17.1	37	1.26
Synopsys SNPS (2)	294.6	1	579.9	4	28.7	29	60.9	7	9.8	7.6	11.0	27	0.94
Veritas Software VRTS	485.0	19	970.8	22	86.5	89	186.5	110	17.8	11.2	11.9	19	1.02
20 SEMICONDUCTORS & SEMICONDUCTOR EQUIPMENT													
INDUSTRY GROUP COMPOSITE	24833.6	34	48003.8	31	3764.7	NM	6949.7	NM	15.2	NM	12.4	28	0.69
Advanced Micro Devices AMD	1261.8	96	2498.3	84	32.2	NM	77.3	NM	2.6	NM	3.5	49	0.24
Agere Systems AGR.A (3)	495.0	9	957.0	6	2.0	NM	76.0	NM	0.4	NM	9.5	39	0.03
Altera ALTR	269.0	31	511.9	28	75.3	109	134.1	102	28.0	17.6	19.7	36	0.58
Amkor Technology AMKR	492.5	30	957.2	33	10.0	NM	20.9	NM	2.0	NM	14.1	12	0.34
Analog Devices ADI (2)	678.5	35	1283.9	32	152.6	114	269.4	105	22.5	14.2	12.1	35	1.12
Applied Materials AMAT (2)	2018.1	82	3573.6	65	373.3	NM	455.7	NM	18.5	NM	5.0	66	0.25
Atmel ATML	420.8	32	828.2	35	11.7	NM	22.7	NM	2.8	NM	0.2	NM	0.00
Broadcom BRCM	641.3	70	1214.7	72	63.8	NM	103.7	NM	10.0	NM	5.4	NM	0.30
Cypress Semiconductor CY	264.3	30	518.7	35	22.0	NM	48.5	NM	8.3	NM	13.7	20	0.56
Fairchild Semiconductor Intl. FCS	414.3	19	812.1	16	17.0	NM	30.0	NM	4.1	NM	2.5	62	0.23
Freescale Semiconductor FSL	1461.0	31	2857.0	26	43.0	NM	149.0	NM	2.9	NM	NA	NA	NA
Intel INTC	8049.0	18	16140.0	19	1757.0	96	3487.0	93	21.8	13.1	19.0	22	1.11
KLA-Tencor KLAC (6)	450.4	46	840.2	37	96.2	228	162.3	186	21.4	9.5	9.3	32	1.21
Lam Research LRCX (6)	329.6	77	560.7	50	52.7	NM	71.8	NM	16.0	2.0	10.2	40	0.59
Linear Technology LLTC (6)	238.1	44	447.2	40	98.8	50	184.4	46	41.5	39.8	18.1	38	1.02
LSI Logic LSI	447.9	10	900.3	15	7.2	NM	16.3	NM	1.6	NM	-0.4	NM	-0.02

[illegible]	SALES				PROFITS				MARGINS				
	2ND QUARTER 2004 $ MIL	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	2ND QUARTER 2004 $ MIL	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	2ND QUARTER 2004 %	2ND QUARTER 2003 %	RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE EARNINGS RATIO 7-29	12 MONTHS EARNINGS PER SHARE
:rochip Technology MCHP (9)	212.8	32	404.3	26	56.8	321	103.6	123	26.7	8.4	13.2	34	0.85
:ron Technology MU (4)	1116.8	52	2107.8	39	90.9	NM	62.6	NM	8.1	NM	-1.1	NM	-0.11
ional Semiconductor NSM (7)	571.2	34	1084.8	31	126.4	NM	219.5	NM	22.1	NM	18.6	21	0.82
vellus Systems NVLS	338.2	41	601.1	26	37.8	409	54.5	182	11.2	3.1	1.5	NM	0.20
DIA NVDA (11)	471.9	17	944.0	13	21.3	8	45.5	-36	4.5	4.9	7.0	35	0.44
adyne TER	526.5	59	957.1	44	80.5	NM	120.7	NM	15.3	NM	5.1	65	0.26
as Instruments TXN	3241.0	39	6177.0	36	441.0	264	808.0	239	13.6	5.2	14.2	21	1.00
nx XLNX (9)	423.6	35	827.0	34	95.3	106	226.1	136	22.5	14.8	14.1	30	0.97
TECHNOLOGY HARDWARE & EQUIPMENT													
USTRY GROUP COMPOSITE	129587.6	17	255491.2	16	7805.1	922	14056.5	271	6.0	0.7	12.0	31	0.65
COMMUNICATIONS EQUIPMENT													
DUSTRY COMPOSITE	23062.7	33	45090.6	28	2310.5	129	5034.2	178	10.0	5.8	13.5	34	0.50
drew ANDW (3)	493.0	131	940.1	127	17.8	112	28.1	317	3.6	3.9	2.0	56	0.19
diovox VOXX (1)	438.2	46	815.1	36	3.7	77	5.5	69	0.8	0.7	4.1	28	0.61
-ya AV (3)	1016.0	9	2022.0	8	58.0	NM	161.0	NM	5.7	NM	30.0	26	0.57
:o Systems CSCO (5)	5620.0	22	11018.0	18	1211.0	23	2502.0	26	21.5	21.4	17.6	32	0.65
mmScope CTV	312.9	121	548.0	102	84.1	NM	67.7	NM	26.9	NM	12.1	25	0.83
mverse Technology CMVT (11)	221.4	23	424.4	19	7.0	NM	11.9	NM	3.2	NM	0.4	NM	0.02
rning GLW †	971.0**	29	1815.0	21	108.0	NM	163.0	NM	11.1	NM	2.8	NM	0.11
niper Networks JNPR	306.9	86	531.0	65	-12.6	NM	21.0	22	NM	8.2	0.7	NM	0.10
:ent Technologies LU (3)	2190.0	11	4384.0	0	387.0	NM	455.0	NM	17.7	NM	NM	16	0.19
torola MOT	8700.0	41	17261.0	41	-203.0	NM	406.0	41	NM	1.9	7.7	38	0.42
alcomm QCOM (3)	1340.5	50	2556.2	34	486.4	102	927.7	86	36.3	27.0	17.8	36	1.95
ientific-Atlanta SFA (6)	458.8	14	895.8	14	70.2	48	124.2	67	15.3	11.7	12.1	21	1.41
labs TLAB	304.3	30	568.1	24	49.6	NM	63.0	NM	16.3	NM	-1.1	NM	-0.07
Starcom UTSI †	689.6	70	1311.9	78	43.2	10	98.0	28	6.3	9.7	16.4	10	1.70
COMPUTERS & PERIPHERALS													
DUSTRY COMPOSITE	70287.3	11	138394.0	11	4730.2	99	7738.6	51	6.7	3.8	14.2	25	1.01
ple Computer AAPL (3)	2014.0	30	3923.0	30	61.0	221	107.0	224	3.0	1.2	4.4	57	0.57
ll DELL (11)	11540.0	21	23052.0	20	731.0	22	1480.0	23	6.3	6.3	45.5	33	1.07
-bold DBD	552.0	15	1050.3	18	43.7	6	72.8	8	7.9	8.6	16.1	19	2.47
IC EMC	1971.2	33	3842.8	34	192.8	136	332.6	184	9.8	5.5	6.5	35	0.30
teway GTW	837.6	5	1706.0	4	-335.8	NM	-504.5	NM	NM	NM	NM	NM	-2.22
wlett-Packard HPQ (2)	20113.0	12	39627.0	11	884.0	34	1820.0	32	4.4	3.7	7.7	21	0.97
ation IMN	284.1	6	623.4	15	7.3	-61	29.0	-28	2.6	7.1	8.3	17	1.94
ernational Business Machines IBM	23153.0	7	45403.0	9	1990.0	15	3593.0	15	8.6	8.0	28.1	19	4.67
xmark International LXK	1247.7	11	2503.7	12	136.6	34	257.6	31	10.9	9.1	25.7	23	3.77
axtor MXO	818.3	-10	1837.9	-1	-26.1	NM	-16.9	NM	NM	0.7	7.0	24	0.19
CR NCR	1452.0	6	2742.0	5	122.0	NM	117.0	NM	8.4	NM	11.1	20	2.25
twork Appliance NTAP (8)	337.0	39	634.3	35	36.4	47	76.6	72	10.8	10.3	10.7	45	0.42
lmOne PLMO (7)	267.3	23	509.8	23	13.3	NM	4.0	NM	5.0	NM	-2.1	NM	-0.26
nDisk SNDK	433.3	85	820.2	100	70.6	71	134.2	103	16.3	17.6	14.5	19	1.28
agate Technology STX (6)	1336.0	-14	2724.0	-14	-33.0	NM	126.0	-62	NM	10.3	28.6	11	1.06
orage Technology STK	516.6	-2	1031.7	2	35.6	18	59.0	27	6.9	5.7	11.3	17	1.45
n Microsystems SUNW (6)	3110.0	4	5761.0	0	795.0	NM	35.0	NM	25.6	NM	-5.8	NM	-0.11
ova UNA	304.2	9	601.9	11	5.7	556	16.2	NM	1.9	0.3	3.7	62	0.27
) ELECTRONIC EQUIPMENT & INSTRUMENTS													
DUSTRY COMPOSITE	32384.6	22	64326.6	21	556.4	NM	910.7	NM	1.7	NM	-1.0	NM	-0.10
gilent Technologies A (2)	1831.0	25	3474.0	21	104.0	NM	175.0	NM	5.7	NM	-42.6	NM	-2.87
gilysys AGYS (9)	386.7	38	758.2	40	4.0	NM	10.2	NM	1.0	NM	5.2	28	0.53
mphenol APH	387.1	27	742.4	27	40.4	107	76.0	78	10.4	6.4	34.3	20	1.54
nixter International AXE	813.1	26	1577.3	21	16.8	130	30.8	76	2.1	1.1	8.1	23	1.48
rrow Electronics ARW	2750.2	30	5425.7	32	66.9	879	96.4	NM	2.4	0.3	6.0	23	1.02
VX AVX (9)	345.0	34	660.8	28	22.9	NM	16.7	NM	6.6	NM	-4.9	NM	-0.40
ell Microproducts BELM	630.3	25	1290.6	25	1.1	NM	2.8	NM	0.2	NM	2.8	32	0.21
nchmark Electronics BHE	491.4	9	972.4	8	17.6	49	32.8	13	3.6	2.6	8.4	20	1.41
rightpoint CELL	463.8	25	905.1	29	5.1	-2	8.4	157	1.1	1.4	15.2	13	1.02
DW CDWC	1382.9	29	2719.6	30	58.3	34	113.6	32	4.2	4.1	18.2	28	2.33
ellStar CLST (1)	345.4	-17	816.5	-7	0.7	NM	2.7	NM	0.2	NM	1.9	31	0.17
lobal Imaging Systems GISX (9)	212.0	18	406.0	12	12.9	200	25.1	87	6.1	2.4	14.7	15	2.01
TSI GTSI	239.0	26	417.6	13	-1.6	NM	-2.9	NM	NM	0.6	1.1	NM	0.09
gram Micro IM	5716.6	11	11992.2	13	25.9	125	63.4	194	0.5	0.2	9.8	11	1.23
abil Circuit JBL (4)	1625.9	33	3117.7	32	40.1	799	80.1	450	2.5	0.4	8.1	31	0.69
lolex MOLX (6)	631.8	33	1201.0	31	57.2	NM	102.7	284	9.1	0.4	8.5	31	0.92
axar PXR	214.0	17	402.8	16	15.8	126	24.5	192	7.4	3.8	7.7	25	0.77
C Connection PCCC	335.3	4	663.0	10	2.3	61	3.4	15	0.7	0.4	3.9	29	0.26
erkinElmer PKI	412.6	10	805.2	10	20.9	91	34.6	135	5.1	2.9	5.5	30	0.58
lexus PLXS (3)	274.8	40	529.1	37	-0.8	NM	2.7	NM	NM	NM	0.3	NM	0.03
anmina-SCI SANM (3)	3069.8	16	5932.2	16	11.4	NM	-32.5	NM	0.4	NM	-3.1	NM	-0.20

COMPANY SYMBOL	SALES 2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	PROFITS 2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	MARGINS 2ND QUARTER 2004 %	2ND QUARTER 2003 %	[illegible] 6:30	[illegible]	[illegible]
Solectron SLR (4)	3039.9	29	5927.3	26	-65.4	NM	-155.1	NM	NM	NM	-16.1	NM	-0.
Symbol Technologies SBL	432.8	16	852.4	12	28.8	336	35.6	NM	6.7	1.8	6.4	48	0
SYNNEX SNX (1)	1273.1	35	2495.2	36	10.2	45	19.9	45	0.8	0.7	11.1	11	1.
Tech Data TECD (11)	4822.3	23	9741.0	23	34.7	61	73.6	NM	0.7	0.6	7.1	18	2.
Tektronix TEK (7)	257.8	27	501.3	29	26.5	522	70.3	NM	10.3	2.1	13.6	22	1.
(D) OFFICE ELECTRONICS													
INDUSTRY COMPOSITE	3853.0	-2	7680.0	0	208.0	142	373.0	NM	5.4	2.2	14.7	19	0
Xerox XRX	3853.0	-2	7680.0	0	208.0	142	373.0	NM	5.4	2.2	14.7	19	0
MATERIALS													
SECTOR COMPOSITE	102335.2	17	197156.2	16	6011.5	86	10037.1	98	5.9	3.7	9.1	30	1.
22 MATERIALS													
INDUSTRY GROUP COMPOSITE	102335.2	17	197156.2	16	6011.5	86	10037.1	98	5.9	3.7	9.1	30	1.
(A) CHEMICALS													
INDUSTRY COMPOSITE	41055.8	13	80244.5	14	2866.5	38	5174.3	47	7.0	5.7	13.3	26	1.4
Air Products & Chemicals APD (3)	1892.5	16	3749.0	17	163.0	513	304.2	117	8.6	1.6	13.4	21	2.4
Airgas ARG (9)	544.0	18	1066.1	18	22.1	19	43.8	19	4.1	4.0	11.5	20	1.
Albemarle ALB	326.8	20	648.8	20	20.8	-12	34.4	-28	6.4	8.7	9.6	22	1.
Arch Chemicals ARJ	402.8	31	681.5	28	25.2	102	28.2	87	6.3	4.1	7.6	23	1.
Dow Chemical DOW	9844.0**	19	19153.0	17	685.0	74	1154.0	141	7.0	4.8	24.4	16	2.
DuPont DD	7527.0	2	15600.0	9	503.0	-25	1171.0	-5	6.7	9.2	9.3	47	0.
Eastman Chemical EMN	1676.0**	13	3273.0	12	84.0	140	78.0	47	5.0	2.4	-23.7	NM	-3.2
Ecolab ECL	1042.7	10	2022.1	11	78.3	17	144.3	18	7.5	7.1	21.5	27	1.1
Engelhard EC	1107.8	19	2147.8	22	68.0	26	118.3	5	6.1	5.8	17.8	15	1.
FMC FMC	534.3	5	1040.0	10	40.8	88	48.1	104	7.6	4.3	9.9	25	1.7
Fuller (H.B.) FUL (1)	363.1	12	681.6	10	11.7	20	16.3	25	3.2	3.0	8.0	18	1.4
Grace (W.R.) GRA	572.4	14	1090.9	15	21.3	228	37.1	783	3.7	1.3	NM	NM	-0.3
Great Lakes Chemical GLK	454.0	9	822.1	10	27.8	64	23.7	33	6.1	4.1	-3.7	NM	-0.5
Hercules HPC	510.0	7	985.0	6	4.0	-88	30.0	-35	0.8	6.7	78.2	22	0.5
IMC Global IGL	748.8	39	1333.0	22	42.7	93	54.3	NM	5.7	4.1	3.1	NM	0.1
International Flavors & Fragrances IFF	524.2	9	1059.2	12	56.5	10	112.9	35	10.8	10.7	24.9	17	2.1
Lubrizol LZ	721.5	40	1300.2	27	3.9	-87	41.5	-25	0.5	5.7	7.9	24	1.4
Lyondell Chemical LYO	1161.0	27	2266.0	19	3.0	NM	-12.0	NM	0.3	NM	-12.7	NM	-0.7
Monsanto MON (4)	1679.0	14	3171.0	15	229.0	28	385.0	31	13.6	12.2	6.0	85	0.4
PPG Industries PPG	2429.0	5	4693.0	7	183.0	20	298.0	26	7.5	6.6	18.4	18	3.2
Praxair PX	1603.0	14	3134.0	14	175.0	17	339.0	21	10.9	10.7	20.2	20	1.9
Rohm & Haas ROH	1801.0	15	3633.0	14	118.0	NM	232.0	194	6.6	NM	12.6	20	1.9
RPM International RPM (7)	680.9	15	1161.6	14	53.0	NM	59.0	NM	7.8	NM	14.5	12	1.2
Schulman (A.) SHLM (4)	331.3	11	622.5	10	12.9	443	18.2	158	3.9	0.8	6.5	22	0.9
Scotts SMG (3)	804.1**	10	1548.6	9	100.3	10	173.4	13	12.5	12.4	11.6	20	2.9
Sensient Technologies SXT	263.8	1	518.0	4	18.2	-16	33.2	-21	6.9	8.3	12.2	13	1.5
Sigma-Aldrich SIAL	348.6	7	716.7	8	59.6	24	121.9	26	17.1	14.7	19.9	19	3.0
Spartech SEH (2)	287.6	15	529.1	14	13.5	28	21.2	27	4.7	4.2	9.7	19	1.2
Stepan SCL	236.3	18	457.7	18	3.8	-20	7.8	11	1.6	2.4	3.2	46	0.5
Valspar VAL (2)	638.4	14	1140.0	11	39.1	22	57.5	20	6.1	5.7	13.0	21	2.3
(B) CONSTRUCTION MATERIALS													
INDUSTRY COMPOSITE	1587.9	19	2841.9	21	158.6	94	219.7	165	10.0	6.1	12.7	19	2.40
Florida Rock Industries FRK (3)	251.6	27	480.3	33	33.1	44	57.5	47	13.1	11.6	17.6	16	2.55
Texas Industries TXI (7)	519.9**	43	927.9	40	37.6	NM	58.5	NM	7.2	NM	5.2	28	1.5
Vulcan Materials VMC	816.3	6	1433.8	8	87.9	33	103.6	51	10.8	8.6	13.9	19	2.50
(C) CONTAINERS & PACKAGING													
INDUSTRY COMPOSITE	13917.4	6	26884.8	7	512.7	-2	696.4	-3	3.7	4.0	-1.3	NM	-0.15
AptarGroup ATR	311.8	8	627.4	13	22.8	7	44.0	9	7.3	7.4	10.3	19	2.23
Ball BLL	1467.2	8	2698.7	11	90.7	22	137.5	30	6.2	5.5	29.3	16	4.59
Bemis BMS	712.9	6	1397.0	7	45.8	18	88.8	20	6.4	5.8	13.4	18	1.50
Crown Holdings CCK	1836.0	6	3459.0	9	33.0	-34	15.0	-6	1.8	2.9	-18.5	NM	-0.20
Greif GEF (2)	542.2	15	1011.0	12	8.4	NM	5.1	NM	1.6	NM	2.4	60	0.63
Longview Fibre LFB (2)	213.4	18	383.3	3	5.9	NM	-3.3	NM	2.8	0.3	0.0	NM	0.00
Owens-Illinois OI	1716.3	9	3261.7	10	82.0	382	131.0	155	4.8	1.1	NM	NM	-6.36
Packaging Corp. of America PKG	467.4	7	898.6	5	13.6	27	6.8	-62	2.9	2.5	-3.3	NM	-0.25
Pactiv PTV	858.0	6	1633.0	7	52.0	-12	52.0	-50	6.1	7.3	15.2	26	0.90
Rock-Tenn RKT (3)	397.3	8	797.3	11	-4.1	NM	-1.1	NM	NM	2.1	2.9	40	0.36
Sealed Air SEE	823.7	-5	1836.8	9	61.4	-7	121.5	-5	7.5	7.6	17.4	22	2.21
Silgan Holdings SLGN	551.3	1	1069.6	7	18.2	35	29.3	66	3.3	2.5	34.8	16	2.90
Smurfit-Stone Container SSCC	2038.0	3	3980.0	3	-7.0	NM	-70.0	NM	NM	NM	-11.2	NM	-0.97
Sonoco Products SON	763.9	12	1459.3	9	35.0	64	71.8	47	4.6	3.1	9.7	25	1.03
Temple-Inland TIN	1218.0	3	2372.0	2	55.0	-65	68.0	-51	4.5	13.1	1.3	NM	0.46

PANY SYMBOL	SALES 2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	PROFITS 2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	MARGINS 2ND QUARTER 2004 %	2ND QUARTER 2003 %	RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE EARNINGS RATIO 7-29	12 MONTHS EARNINGS PER SHARE
METALS & MINING													
DUSTRY COMPOSITE	24550.0	37	46137.3	33	1483.0	488	2487.6	341	6.0	1.4	6.9	36	0.98
Steel Holding AKS	1311.8	34	2446.2	24	20.2	NM	3.8	NM	1.5	NM	NM	NM	-4.26
coa AA	6092.0	11	11788.0	11	404.0	86	754.0	83	6.6	3.9	11.1	20	1.58
legheny Technologies ATI	646.5	32	1224.3	26	26.6	NM	-23.8	NM	4.1	NM	NM	NM	-3.55
ch Coal ACI	422.8	12	826.3	17	11.1	NM	81.1	NM	2.6	NM	13.5	17	1.89
rpenter Technology CRS (6)	296.8	40	577.2	29	17.7	222	27.2	278	6.0	2.6	6.5	27	1.49
mmercial Metals CMC (4)	1407.2	82	2475.3	72	50.9	NM	72.0	NM	3.6	0.4	15.6	11	3.23
nsol Energy CNX	674.6**	21	1325.4	19	26.2	148	59.1	324	3.9	1.9	7.5	NM	0.33
eport-McMoRan Copper & Gold FCX	486.3	-20	846.5	-25	-38.2	NM	-57.6	NM	NM	11.0	-0.1	NM	0.03
etals USA MUSA	383.6	58	702.8	50	33.7	NM	52.2	NM	8.8	0.9	22.6	6	2.79
wmont Mining NEM	1024.5	37	2160.0	44	37.5	-59	171.3	-29	3.7	12.2	5.9	39	1.02
ucor NUE	2761.8	82	5048.2	68	251.4	NM	364.7	NM	9.1	0.6	14.8	17	5.06
egon Steel Mills OS	281.8	48	534.2	46	14.0	NM	21.5	NM	5.0	NM	-20.8	NM	-1.65
abody Energy BTU	920.1**	33	1708.7	24	41.5	NM	64.1	NM	4.5	NM	6.8	30	1.83
elps Dodge PD	1650.9	72	3247.9	67	226.6	NM	412.3	NM	13.7	NM	12.6	16	4.77
uanex NX (2)	406.0	59	687.1	42	11.5	23	18.0	11	2.8	3.7	9.6	16	2.72
erson Tull RT	794.7	47	1499.6	38	20.0	NM	32.0	NM	2.5	NM	5.3	19	0.81
eel Dynamics STLD	525.7	140	909.8	100	67.3	NM	99.3	368	12.8	2.5	17.8	14	2.31
eel Technologies STTX (3)	232.0	79	416.9	60	10.5	984	17.4	488	4.5	0.8	11.0	11	2.04
nited States Steel X	3448.0	49	6372.0	51	211.0	NM	255.0	NM	6.1	0.1	-9.5	NM	-1.72
orthington Industries WOR (7)	782.9	33	1341.0	19	39.4	152	64.0	137	5.0	2.6	12.8	20	1.00
PAPER & FOREST PRODUCTS													
DUSTRY COMPOSITE	21224.0	12	41047.6	12	990.6	221	1459.2	678	4.7	1.6	8.3	22	1.79
eorgia-Pacific GP	5188.0	6	10410.0	12	230.0	326	372.0	NM	4.4	1.1	10.7	15	2.30
ternational Paper IP	6486.0	5	12850.0	6	101.0	19	171.0	26	1.6	1.4	4.2	59	0.73
uisiana-Pacific LPX	825.3	74	1520.6	73	189.3	NM	301.6	NM	22.9	1.9	35.3	4	5.31
eadWestvaco MWV	2095.0	9	3928.0	9	48.0	NM	46.0	NM	2.3	NM	2.6	48	0.62
otlatch PCH	472.6	28	893.1	27	49.6	627	71.4	NM	10.5	1.9	22.8	9	4.34
ausau-Mosinee Paper WMO	264.1	9	515.9	7	3.7	16	7.2	58	1.4	1.3	5.3	43	0.36
eyerhaeuser WY	5893.0	20	10930.0	15	369.0	135	490.0	330	6.3	3.2	7.9	21	2.91
ELECOMMUNICATION SERVICES													
CTOR COMPOSITE	60410.1	3	119412.1	2	5981.3	20	11608.8	1	9.9	8.4	10.9	21	1.25
TELECOMMUNICATION SERVICES													
DUSTRY GROUP COMPOSITE	60410.1	3	119412.1	2	5981.3	20	11608.8	1	9.9	8.4	10.9	21	1.25
DIVERSIFIED TELECOMMUNICATION SERVICES													
DUSTRY COMPOSITE	50951.3	1	100970.1	0	4514.0	3	9617.5	-9	8.9	8.7	11.4	20	1.42
lltel AT	2042.1	2	4003.2	2	262.5	17	452.4	0	12.9	11.2	13.6	17	3.07
T&T T	7636.0	-13	15626.0	-12	108.0	-80	412.0	-61	1.4	6.1	8.6	10	1.53
ellSouth BLS	5083.0	0	10059.0	0	939.0	3	2089.0	19	18.5	17.9	17.7	13	2.08
enturyTel CTL	603.6	3	1197.3	3	83.3	-5	166.6	-3	13.8	14.9	10.0	13	2.38
T IDT.C (5)	565.7	24	1092.6	21	-76.8	NM	-58.4	NM	NM	NM	-6.6	NM	-0.74
BC Communications SBC †	10314.0	1	20442.0	-1	1168.0	-16	3105.0	-19	11.3	13.6	13.4	16	1.59
print FON	6869.0	6	13576.0	6	233.0	NM	455.0	379	3.4	NM	2.8	NA	NA
erizon Communications VZ	17838.0	6	34974.0	5	1797.0	42	2996.0	-6	10.1	7.5	9.8	33	1.18
WIRELESS TELECOMMUNICATION SERVICES													
DUSTRY COMPOSITE	9458.8	12	18442.0	13	1467.4	156	1991.3	111	15.5	6.8	9.4	23	0.79
T&T Wireless Services AWE	4219.0	1	8294.0	2	61.0	-73	3.0	-99	1.4	5.5	0.4	NM	0.03
extel Communications NXTL	3289.0	29	6392.0	30	1302.0	321	1895.0	245	39.6	12.1	34.6	9	2.52
ll Holdings NIHD	304.0	35	581.0	35	25.0	-40	-15.0	NM	8.2	18.6	34.5	25	1.52
elephone & Data Systems TDS	934.6	9	1805.1	8	41.4	NM	61.1	NM	4.4	NM	3.9	34	2.25
.S. Cellular USM	712.2	10	1369.9	10	38.0	NM	47.2	NM	5.3	NM	4.3	29	1.37
TILITIES													
ECTOR COMPOSITE	58801.3	7	125573.9	5	3594.2	12	8099.5	8	6.1	5.8	9.7	19	1.62
UTILITIES													
DUSTRY GROUP COMPOSITE	58801.3	7	125573.9	5	3594.2	12	8099.5	8	6.1	5.8	9.7	19	1.62
ELECTRIC UTILITIES													
NDUSTRY COMPOSITE	36259.0	5	74530.2	4	2209.3	0	5004.2	7	6.1	6.4	10.9	17	1.99
lliant Energy LNT	662.1	0	1553.1	-1	-8.4	NM	30.3	-12	NM	2.4	6.4	19	1.40
meren AEE	1152.0	6	2368.0	8	120.0	7	220.0	11	10.4	10.3	10.1	14	3.14
merican Electric Power AEP	3400.0	-3	6700.0	-7	152.0	-12	449.0	-3	4.5	4.9	6.5	26	1.22
INergy CIN	1053.7	13	2342.4	6	59.4	-22	163.2	-25	5.6	8.2	10.1	18	2.10
onsolidated Edison ED	2169.0	0	4854.0	2	89.0	29	247.0	9	4.1	3.2	7.8	17	2.39
TE Energy DTE	1501.0	-6	3594.0	-3	35.0	NM	232.0	227	2.3	NM	11.5	11	3.77
xelon EXC	3550.0	-5	7272.0	-7	521.0	40	901.0	45	14.7	10.0	11.8	22	1.61
irstEnergy FE	3149.8	10	6332.3	4	209.4	766	388.7	154	6.6	0.8	8.1	29	1.36
PL Group FPL	2619.0	12	4950.0	12	257.0	8	395.0	-5	9.8	10.2	12.1	14	4.89
reat Plains Energy GXP	613.5	22	1155.0	19	41.4	-30	70.9	-12	6.8	11.7	13.5	14	2.14
awaiian Electric Industries HE	461.8	3	898.9	3	11.7	-55	43.1	-16	2.5	5.9	9.0	18	1.43

COMPANY SYMBOL	SALES 2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	PROFITS 2ND QUARTER 2004 $ MIL.	CHANGE FROM 2003 %	6 MONTHS 2004 $ MIL.	CHANGE FROM 2003 %	MARGINS 2ND QUARTER 2004 %	2ND QUARTER 2003 %	RETURN ON COMMON EQUITY 12 MONTHS ENDING 6-30	PRICE EARNINGS RATIO 7-29	12 MONTH EARNINGS PER SHARE
Northeast Utilities NU	1524.7	15	3363.0	15	24.3	-14	93.1	4	1.6	2.1	5.4	19	0.98
NSTAR NST	649.8	0	1459.7	4	38.0	-4	87.2	6	5.9	6.1	13.5	13	3.50
Pinnacle West Capital PNW	722.7	6	1297.1	5	71.1	29	100.8	34	9.8	8.0	9.0	14	2.80
PNM Resources PNM	365.6	12	809.3	14	17.0	-4	41.9	46	4.6	5.4	6.6	18	1.18
PPL PPL	1362.0	2	2882.0	2	149.0	27	327.0	12	10.9	8.7	18.6	11	4.20
Progress Energy PGN	2430.0	19	4664.0	10	153.0	-1	261.0	-28	6.3	7.5	9.7	14	2.95
Southern SO	3010.0	7	5742.0	7	352.0	-19	683.0	-6	11.7	15.3	14.6	15	1.94
Teco Energy TE	713.1	3	1355.3	1	-82.5	NM	-53.8	NM	NM	0.7	4.0	NM	-0.29
TXU TXU	2296.0	7	4421.0	9	-92.0	NM	41.0	-79	NM	7.4	13.1	30	1.34
WPS Resources WPS	1045.9	8	2419.2	7	10.7	15	57.1	27	1.0	1.0	14.6	14	3.38
Xcel Energy XEL	1807.4	6	4097.9	8	81.2	49	225.5	25	4.5	3.2	17.0	13	1.33
(B) GAS UTILITIES													
INDUSTRY COMPOSITE	3390.4	15	9763.7	7	93.1	14	558.4	4	2.7	2.8	10.3	14	1.92
New Jersey Resources NJR (3)	438.5	19	1476.2	-3	1.6	-65	52.6	15	0.4	1.2	15.0	15	2.61
NiSource NI	1245.0	9	3718.2	1	36.4	-10	254.0	-4	2.9	3.5	9.2	13	1.57
Peoples Energy PGL (3)	401.1	1	1328.2	2	5.6	-30	60.5	-15	1.4	2.0	10.5	16	2.50
Piedmont Natural Gas PNY (2)	482.4	18	1101.2	22	41.3	33	115.9	30	8.6	7.6	11.2	14	2.90
UGI UGI (3)	823.4	32	2140.0	22	8.3	NM	75.4	11	1.0	NM	12.1	14	2.34
(C) MULTI-UTILITIES & UNREGULATED POWER													
INDUSTRY COMPOSITE	19151.8	11	41280.0	7	1291.8	41	2536.9	7	6.7	5.3	6.9	26	0.96
AES AES	2263.0	14	4520.0	16	67.0	-52	141.0	-48	3.0	7.0	23.5	29	0.33
Avista AVA	225.9	-5	569.6	-1	10.1	-20	22.8	-27	4.5	5.4	5.6	20	0.87
Constellation Energy Group CEG	2793.0	23	5829.5	27	134.2	34	250.0	47	4.8	4.4	13.0	11	3.30
Dominion Resources D	3040.0	16	6919.0	11	262.0	9	711.0	9	8.6	9.1	9.7	20	3.06
Duke Energy DUK	5360.0	4	11049.0	-2	405.0	1	470.0	-26	7.6	7.8	-9.4	NM	-1.50
Dynegy DYN	1440.0	35	3097.0	5	42.0	NM	102.0	NM	2.9	NM	47.8	2	2.47
Equitable Resources EQT	240.6	10	641.1	14	130.8	317	200.9	110	54.4	14.4	28.4	12	4.39
MDU Resources Group MDU	653.3	19	1168.8	15	58.6	35	82.2	15	9.0	7.9	12.3	14	1.68
Public Service Enterprise Group PEG	2290.0	-5	5511.0	-3	120.0	-24	392.0	-19	5.2	6.5	14.0	12	3.24
Scana SCG	846.0	17	1975.0	10	62.0	-18	165.0	2	7.3	10.5	11.9	14	2.57

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The number following each company name identifies the Scoreboard category under which it is listed

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American Axle & Mfg. 1a
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Brunswick 2b
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Wendy's Intl. 3
Werner Enterprises 18d
WESCO International 5a
West 17
West Marine 5d
Westcorp 10a
Weyerhaeuser 22e
WFS Financial 11b
Whirlpool 2a
Wiley (John) & Sons 4
Williams-Sonoma 5d
Winnebago Industries 1b
Worthington Inds. 22d
WPS Resources 24a
Wrigley (Wm.) Jr. 7b
Wyeth 15b

X,Y,Z

Xcel Energy 24a
Xerox 21d
Xilinx 20
XL Capital 12
XTO Energy 9b
Yahoo 19a
Yellow Roadway 18d
York Intl. 16b
YUM! Brands 3
Zale 5d
Zenith Natl. Ins. 12
Zimmer Holdings 14a
Zions Bancorporation 10a

The 529 Ate My Tax Break

Do your homework on these college savings plans. The fees may make you think twice. **BY ANNE TERGESEN**

HAILED FOR THE generous tax break college savings pla sponsored by th states—often call 529 plans, after th section of the feder tax code that created them—are und fire. Among critics' concerns: The hig fees that some plans charge can subst tially erode—and in extreme cases, eve erase—their tax advantages. As a resu participants risk handing over some if n all of the tax savings they realize by in vesting in a 529 to the mutual-fund con panies hired to run the plans.

The solution is to shop carefully for th best deal—comparing various plans' ta breaks, track records, and fees. (If you' already in a plan, you can switch you child's account once a year, free of taxe and penalties.) While that might soun straightforward, it isn't easy to decipher 529 fees. "You have to do a ton of work t find the cheapest plan—and it shouldn be so hard," complains Susan Dynarsk

assistant professor of public policy at rvard University's John F. Kennedy ool of Government. Dynarski should w: She recently scrapped a study of fees because the charges are "buried, lear, or so varied in their nomencla- as to make comparisons impossible." t can be hard enough to understand fees of a single program, never mind 50 of these plans. Consider the fifth- gest in terms of assets, Maine's xtGen College Investing Plan. Of the ens of investments on its menu, nine ne with three price tags each. What pay depends in part on whether buy directly from the plan or ough a broker. Some plans also y extra fees that you must add to a true picture of the cost. For ex- ple, if you've got the average 529 ount balance of $8,200, the ryland College Investment Plan's annual account maintenance —waived under certain circum- nces—adds 0.365% to fees that, in 03, ranged from 0.82% to 1.15%.

The confusion over 529 fees has wn attention from regulators and makers. Congress held hearings ently, and the Securities & Ex- ange Commission formed a task ce to study the level of fees and w they're disclosed. Meanwhile, plans' trade group, the College vings Plans Network, has written idelines to standardize disclo- re—but only on a voluntary basis. at has drawn a skeptical response m House Financial Services Com- ttee Chairman Michael Oxley (R- io): On July 15, he asked the SEC weigh in on whether the agency uld regulate 529 plans.

DING FOR BROKERS

EANWHILE, THE National Associ- on of Securities Dealers is investigating sales practices of 16 brokerage firms t sell various 529 plans. (Some plans sold directly to investors. But a grow- g number are sold either exclusively rough brokers or can be bought either y.) Among the concerns, says NASD ce-Chairman Mary Schapiro, is that th more than 90% of the dollars flow- g into certain plans coming from out- state-residents, some brokers may not adequately disclosing state income-tax ductions you can often get with your me state's plan. Twenty-seven plans of- state tax deductions, but only to those residents who keep their dollars in-state.

Fees can make a big difference in how much you're able to accumulate. Someone who invests $10,000 for a newborn will have $28,449 in 18 years—assuming annual returns of 8% and average costs of 1.87%. But with fees of only 0.65%, you'd accumulate $35,534, or nearly 25% more.

Moreover, it makes no sense to contribute to a 529 plan if the fees eat up your tax savings. To gauge the prospects of that happening, calculate the difference between what you'll pay for a 529 and another investment. If you're in the 28% federal tax bracket and the 529 you're looking at offers a tax deduction, steer clear when the 529's price tag is 1.65 percentage points a year or more above that of a taxable alternative, advises Dynarski. Without a state tax deduction, the 529 becomes a bad bet when it costs 1.3 percentage points more (table). Since several plans, including offerings by Arizona and Rhode Island, feature options that charge about 2% a year or more, it's not hard to find situations where a taxable investment is the better deal.

To get a feel for how the plans' fees compare, you can find data on Web sites such as savingforcollege.com or morningstar.com. But since plans often charge a wide range of fees, you'll need to dig deeper to ascertain your potential costs.

Start with the "program description" or "plan disclosure" documents available at plan Web sites. (You can find links at www.collegesavings.org.) Be forewarned, though, that because disclosure is not uniform, the presentations vary. While some plans disclose fees in one place, others sprinkle the information throughout the reports. And while some states publish an all-inclusive number, others break out the parts.

When High Fees **Erase** Tax Advantages

Is your 529 plan a better deal than a similar mutual fund? To find out, calculate the fee gap—the difference between the total charges on the 529 and the mutual fund. If the gap is higher than amount shown below, opt for the mutual fund.

HOUSEHOLD INCOME	FEDERAL BRACKET	FEE GAP WITH DEDUCTION*	FEE GAP WITHOUT DEDUCTION**
$35,000	10%	0.85%	0.60%
$50,000	15	1.00	0.70
$100,000	25	1.60	1.25
$150,000	28	1.65	1.30
$200,000	33	1.75	1.40
$335,000+	35	1.80	1.45

* These calculations assume you take $1,000 of earnings, pay taxes on it, and deposit the remainder in a 529 account for a newborn. The entire contribution is deductible from state taxable income. And when the child attends college, the balance is drawn down over four years. Income is for a jointly filing married couple with two children and one working parent. Calculations assume the couple pays a median marginal state tax rate for each income group. Breakeven fees will be higher in states with tax rates that are above the median. Breakeven fee differentials will be lower for shorter investment horizons.

**Assumes no tax deduction on the $1,000 contribution.

Data Susan Dynarski at Harvard University

THE NO-LOAD ROUTE

TO GET AN apples-to-apples comparison, tally each plan's fees. Consider Colorado's Scholars Choice College Savings Program, run by Citigroup Asset Management. Like many plans, this one sells no-load shares directly to investors who download an application or ask that one be mailed. You can also buy one of three share classes from a broker. The difference between them? Fees.

You're likely to come out ahead by buying directly. According to a table that lists total fees on page 34 of the disclosure, you'll pay 1.09% a year if you go the no-load route. Although annual fees on the "A" shares can be lower—the range is from 0.85% to 1.14%—you'll also forfeit 3.5% of your contributions to your broker. That means that for every $100 you invest, your broker pockets $3.50, leaving just $96.50 in your account.

To figure out your exact annual cost, you need to go two pages ahead, to a table which lists fees for the plan's eight underlying funds. The charges range from 0.44% on the Smith Barney Cash Portfolio to 0.94% on the American Fund's AFG EuroPacific Growth fund.

Most investors opt for an age-based portfolio, which automatically shifts money from stocks to bonds as college approaches. Say you have $10,000 to invest for a 10-year-old. To figure out the cost of the appropriate age-based portfolio, you'll need to look up how the plan allocates money for a child of 10—information that's on page 9 of the disclosure.

Of your $10,000 investment, 20%, or $2,000, will be invested in the Salomon Brothers Investors Value fund. Since the fund charges 0.66% of assets a year, that

works out to $13.20 in fees on a $2,000 investment. Another 20% goes into the Smith Barney Large Cap Growth Fund. With fees of 0.76%, the tab on $2,000 is $15.20. Five percent more, or $500, of your investment is put in the Smith Barney Small Cap Core Fund, which charges 0.80%—and so on. To arrive at your overall investment fee, calculate what you'll pay in dollars for each fund. Then, add the figures, and divide by your $10,000 investment. The result: about 0.73%.

EARLY PENALTIES

THAT'S NOT your total cost. According to the total fee table, on page 34, there's a 0.10% "Authority Administration Fee," which goes to Colorado to cover its expenses. This amount—about average for 529 plans—bumps you up to 0.83%.

You're not done yet. While fund and state agency fees come to 0.83%, the total cost for a no-load share is 1.09%. The 0.26% difference pays for marketing and record-keeping. Up to 0.30% is "reasonable," says Dan McNeela, a senior analyst at Morningstar.

Opt for an "A" share instead, and you'll pay a different price. On top of 0.73% in fund fees, you'll pay Colorado 0.10% and your broker 0.25% in "distribution fees." The total, 1.08%, is slightly less than the no-load's 1.09%. But once you factor in 3.5% initial sales charge, the A shares are far pricier.

Neither B nor C shares charge an upfront commission. However, since they respectively levy distribution fees of 0.95% and 0.75%, their totals come to 1.78% and 1.58% a year. That's below average for a broker-sold option, but above the 0.80% to 1.2% that Joseph Hurley, founder of savingforcollege.com, considers moderate for direct-sold 529s.

Your broker may simply be pushing what gives him a high payout

If you bail out of a share within five yea you'll forfeit 0.5% to 2.5% your money. After the s enth year, B shares conv to A shares. Meanwhile your broker is pushing shares, you might be int ested in the fine print t reveals that brokers get highest annual payout fr them—0.75%, vs. 0.25% A and B shares.

Finally, if neither you nor your ben ciary live in Colorado and your balanc below $2,500, watch out. Colora charges a $20 annual maintenance f which adds at least 0.80% to your cost

Do these fees nullify the tax bene Depending on your tax bracket and t alternative investment you have in mi they may. So do the math before comm ting your college savings to a plan tha going to fritter away your tax benefits.

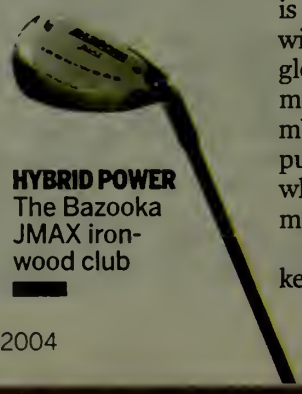
Golf

Swinging in Style

Gear to get your groove back. **BY DEAN FOUST**

IF YOU'RE A GOLFER WHO'S IN A funk over your game this summer, fear not. A raft of new equipment could help you get your groove back. ¶ For relief off the tee, TaylorMade Golf's revolutionary r7 quad driver ($499, taylormadegolf.com) comes with four tungsten screws that users can move around to change the weighting in the club head. That means, for instance, that golfers with a knack for hitting slices could reposition the heaviest screws to the two slots closest to the shaft—and improve the odds of keeping their drives in play.

If your problem lies in the fairways, consider TourEdge clubs (touredge.com). The company offers a complete 13-club line of hybrids known as the Bazooka JMAX that blend the loft of irons with the forgiveness and ease-of-use of fairway woods ($70 each, steel shafts; $80, graphite). The JMAX hybrids are ideal for novices who simply need to play a few respectable rounds of business golf each year.



HYBRID POWER The Bazooka JMAX ironwood club

If you're looking for help with your short game, consider Cleveland Golf's CG10 wedges ($120, clevelandgolf.com). Thanks to a new steel that's infused with 17 times more carbon, the CG10 wedges offer more feel and forgiveness than many other wedges you'll hit.

On the green, the most unique putter this year may well be the hammY putter ($150 to $180, hammYputter.com), which is more like a hockey stick, with a split-hand grip and angled shaft. By promoting a more opened stance, the hammY enables golfers to see the putting line with both eyes, which may well result in more made putts.

Finally, if you're in the market for a new golf bag, Ogio International's Stinger II cart bag ($25 ogio.com) comes with a proprietar hinge that buckles to the cart—and the allows you to tilt the bag at a 45-degre angle away from the vehicle. The resul You may never have to fumble for a clu again. Even if your game doesn't im prove, you're still guaranteed to tur heads on the course. ■

EASY ACCESS Ogio's ca bag

ON TV, TOO Millions ride on poker's World Series

Poker that Needs No Poker Face

s the game draws in younger players, line sites are thriving. **BY JASON STRASSER**

CHRIS MONEYMAKER declared: "I'm all in," putting all his chips at stake. The game is a poker variant called Texas Hold 'Em, in which each player gets two cards and table, five. From the seven, the players to make a winning five-card hand or their opponents into thinking they e. In this case, the cards on the table e lousy: a 9, 2, 6, 8, and 3, three of ich were spades. Moneymaker didn't n have a pair.

Sammy Farha, his remaining oppo- t, stared him down. "You missed your h," Farha said, trying to get a read on opponent. Farha held a pair of nines. nutes passed. Finally, Farha shook his d and folded. Moneymaker won the nster pot in one of the most famous ffs in poker history, and went on to the 2003 World Series of Poker and $3 million prize on the next hand.

Thanks to colorful gamblers, celebrity players such as Ben Affleck and Matthew Perry, and a lipstick-size camera that lets television viewers peek at the players' cards, the age-old of game of scruffy cowboys and cigar chompers is new again. TV poker has become a display of deception, a reality show where wits, guts, and a little luck can turn a nobody accountant like Moneymaker into a millionaire.

Of course, poker is not just a spectator sport. Spurred by the growing coverage on TV, teens are putting down their videogame controllers and picking up the cards. Thousands of players, from college kids to grandmothers, are joining the action on the Internet. According to PokerPulse, $100 million is wagered each night in online poker. Some of the larger sites can attract up to 40,000 or 50,000 players a night.

Is it legal? Many of the online sites are located offshore, beyond the U.S. government's reach. Technically, anyone 18 or older can legally play at a Web site based offshore. Regulators have made it tough to use credit cards, but the sites will take an electronic check. Online poker joints based in the U.S. say players must be 21, but no one's checking IDs at the door.

GREENHORNS GALORE

YOU CAN'T TWIRL your chips or read your opponents' faces, but online has its advantages. You can play whenever or wherever you want. You're anonymous, known by a screen name, and so you're less likely to be embarrassed by bad moves. Online leaves more money for the players, too. In any card room, the house's cut, or "the rake," is 10% of every pot. The maximum rake, or cap, is usually $3 online and $4 in casinos. Over the course of many hands, that dollar makes a huge difference.

Because online poker draws lots of inexperienced players, the venue is rewarding for the skillful. Among them is Justin Bonomo (ZeeJustin on PartyPoker.com), 18, from Centreville, Va. He uses two monitors to play as many as eight tables at once and says he has turned a $250 stake into more than $90,000 in a year. Bonomo will soon enroll at the University of Maryland, but he aspires to a career in poker. "There's no doubt in my mind that I can make a very comfortable living off of poker," he says.

CELEB PLAYER Matthew Perry of *Friends*

Not all the stars are kids. David Ross, 44, who goes by the name davidross on PartyPoker and PokerStars.com, plays 35 to 45 hours a week and through it supports his wife and four children. "I love the freedom it has given me in terms of time and money," says Ross, who just finished his first year as a full-time player and made $82,000. The occa-

Poker Tips

- **READ UP** on the theory. The books can be dense, but grasping the theory of poker will give you an edge.
- **PAY ATTENTION** to your opponents, even when you aren't involved in a hand. You'll learn their style, and that will help you play against them.
- **KEEP THE FAITH.** In the short term, a run of bad luck can hurt you. Over the long term, smart playing should pay off.

sional losing streaks are tough to handle, he says, "but I have confidence that they will end."

If you don't want to be an easy mark for Bonomo or Ross, then you should do a little studying. David Sklansky's *The Theory of Poker* is a good primer, and you might follow that up with Sklansky's *Hold 'Em Poker*. You can also tap the knowledge of the poker community at various message boards. Greg Raymer, who won $5 million in the 2004 World Series of Poker, credits the message boards at TwoPlusTwo.com for helping him improve his game. Other good resources include the United Poker Forum (unitedpokerforum.com), and the news group, rec.gambling.poker.

$50 UP FRONT

WHEN YOU'RE READY to play, it's better to start with the larger sites, such as Party Poker, PokerStars, or UltimateBet.com. Because bigger casinos take in more revenue, they generally spend more on security and support, including staff who will investigate suspected cheaters. Start w the big names, and if they aren't for y look for alternatives. Money can be posited easily through a checking acco or a wire transfer. Most sites have a m imum deposit of around $50. Card ro often offer first-time players a bonu 10% to 20% of their deposit, so keep eye out for these promotions. If yo rather practice before you send mone and you probably should—all the sites fer a "play money" option.

Famous poker players such as Ivey, Daniel Negreanu, and Dan Harri ton will never have the name recogni of a Derek Jeter or a Shaquille O'N Still, as poker becomes more of a ma stream entertainment, don't be surpri if the kids in the house start asking f set of poker chips instead of the la video game. ■

Health

Nail That Fungus

But treatments can be costly. **BY KATE MURPHY**

SUMMER IS SANDAL SEASON, but not if you have toenail fungus. Called onychomycosis, it causes toenails to become crusty, discolored, and malformed. Doctors say the incidence is increasing because of an aging population (age makes you more susceptible) and the popularity of gyms and nail salons. More treatments are available, but they take time to work—and they're pricey.

The fungus, the same organism that causes athlete's foot, thrives in damp environments such as pool areas and locker rooms, but it also lurks in hotel rooms and can even hitch a ride on your pet. "You'd be surprised at all the places you can pick it up," says Asra Ali, assistant professor of dermatology at the University of Texas Medical School at Houston. The fungus rarely infects fingernails because they are exposed to air and light. You're more likely to get it if your parents had toenail fungus, you smoke, have a weakened immune system, or have cuts and cracks in your nails or cuticles.

If you spot a white, scaly-looking mark on a toenail, see your family doctor, podiatrist, or dermatologist. A scraping can be tested to confirm the diagnosis. If the infection is mild, the most common therapy is to trim the affected part of the nail and apply a topical lacquer. Many over-the-counter varieties are on store shelves. Penlac by Dermik Laboratories, which requires a prescription, is approved by the U.S. Food & Drug Administration. It costs around $250 for the recommended 48-week course. You paint it on like nail polish every day. Once a week, you use alcohol to remove the accumulated layers and start over. Its efficacy is improved if you file the top of your nail to improve penetration.

A more serious infection may requ an oral antifungal like Lamisil, made Novartis, or Sporanox, from Janss Pharmaceutica Products. They can c more than $900 for a standard thr month course. Insurance often wo cover the cost because toenail fungu considered a cosmetic problem ev though it can be painful or dangerou you get a secondary bacterial infecti The drugs can have serious side effe such as liver damage, so you'll need blo tests while you're on them. Home rem dies that may work over a six-month p riod include daily applications of tea t oil or Vicks VapoRub, or soaking yo toes in a 1:2 vinegar and water solutio

The best tre ment, of course, prevention. Use antifungal foot po der if your fe sweat a lot. C your toenails sho and so they mat the contour of yo toes. Wear flip-flo in public showe and slippers in ho rooms. Go to censed nail salo and take your ov tools. And, as yo mother already to you, change yo socks every day. ■

ITED BY TODDI GUTNER

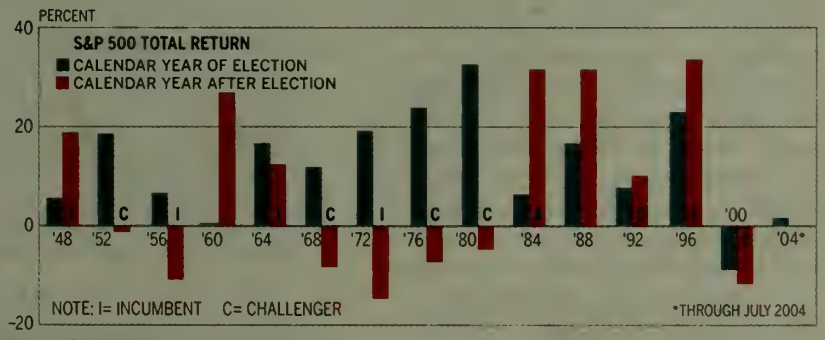
UTUAL FUNDS

Directors Wanted

LP WANTED: To comply with new Securities & Exchange Commission rules ndating that 75% of mutual-fund directors or trustees be independent, funds may on need to hire a slew of directors. In fact, Irving Straus, a New York fund nsultant, figures at least half of the 7,000 funds will need to do so. Those jections, however, might be overstated, since at many fund complexes one board ersees multiple portfolios. Some funds are expected to simply drop directors with s to the management company to increase the independent-to-insider ratio. Even so, many fund boards will need help. Do you qualify? Christopher Traulsen, Morningstar analyst, says directors should understand financial statements and w the fund industry operates. More important, says Traulsen, "they should be able stand up for fund shareholders and take a stand against a fund's adviser." Annual pay for independent directors can range from $5,000 at a small fund mpany to $100,000 at some of the larger complexes. It's a nice gig, considering at at many funds, directors meet just four times a year. *–Lauren Young*

IVESTING

HAT WOULD A PRESIDENT KERRY mean for the stock arket's near-term prospects? If historical trends hold, the utlook isn't great. That's not because he's a Democrat, but ecause the party in control of the White House would hange—and that's what rattles vestors. Since 1948, the Standard & oor's 500-stock index rose 0.5%, on verage, in the first year after an cumbent party lost. In the first year of new term for the incumbent party, ocks rose an average 14.7%, says bertyville (Ill.) financial-research firm randall, Pierce. *–Anne Tergesen*



Data: Crandall, Pierce & Co.

EDUCATION

E-WRITERS RULE

MISSING COMMAS and run-on sentences may not be a bad thing for teenagers engaged in writing-intensive online activity, says Purdue University English professor Samantha Blackmon. "I want to see teenagers writing more, and if that means they break a few grammar rules, that's O.K.," says Blackmon, who believes grammar is easier to teach than a love of writing to students who blog, e-mail, and instant message. *–Seth Porges*

SPIRITS

LEMON, ITALIAN STYLE

WHEN THE WEATHER gets torrid, the Italians—who know a thing or two about good living—enjoy an icy shock of refreshment from a distinctive lemon-infused liqueur. Now, Italy's most popular brand, Limoncé Limoncello, has become widely available here. The liqueur, from the maker of Stock brandies and vermouths, should be kept in the freezer for serving after dinner or as a palate-cleanser between courses. It's usually sipped straight in Italy, but you can also crown it with tonic or champagne. It runs about $19 for a one-liter bottle, and $15.50 for a 750-ml bottle. *–Gerry Khermouch*

BY ROBERT BARKER

Day Trading: It's Not Always a Fool's Game

Ken Jennings is good—extremely good. With 38 straight victories this summer on TV's venerable trivia game, *Jeopardy!*, the software engineer rolled up a record $1,321,660 in winnings. In his latest contest, he scored $75,000, smashing the old one-day record of $52,000. No doubt, Jennings is a superior *Jeopardy!* player.

He has mixed smarts, nerve, disciplined study, years of practice, a knack for figuring odds on the fly, and fleet brain-to-thumb reflexes. Yet how many of us would credit his talent and skill if Jennings had done as well by trading stocks 38 days in a row? Conventional wisdom has concluded that day trading is a short-cut to financial ruin. The stock market's ruthless efficiency inevitably makes every trader a loser, or so we're often told. Day trading is about the last thing I would do, yet this orthodoxy makes no sense to me. Yes, trading is tough work. But why must it be a fool's game? Why, when so many Wall Street firms trade profitably year after year?

NOW, THERE'S FRESH EVIDENCE that day trading successfully is not beyond individuals willing and able to commit the time, sweat, and brainpower to build superior skills. Those who dabble will likely lose—very badly. *Do Individual Day Traders Make Money? Evidence from Taiwan*, is a working paper issued in May by Yi-Tsung Lee and Yu-Jane Liu of National Chengchi University in Taipei, and Brad Barber and Terrance Odean of the University of California (at Davis and Berkeley, respectively). Noted veterans of behavioral finance, the UC economists have long tracked the moves of individual investors. Lee and Liu, having done research for the Taiwan Stock Exchange (TSE), struck a gold mine of data—the full exchange trading record from 1995 to 1999, including each trader's identity. The four academics got together, since no similar trove has been available in the U.S. and day trading is popular in Taiwan. As a pioneering study, the results are merely suggestive. But if you think, as Liu does, that Taiwan's day traders act much like those elsewhere, the findings are intriguing. "Day trading is really hard. Most people lose their shirts," Barber says.

Hot Hands

Researchers examined the full 1995-99 transaction records of all day traders on the Taiwan Stock Exchange. One finding: While the average day trader lost money, an elite group of traders who had had strong performances over the prior six months kept cleaning up, even after transaction costs.

Average Trader's Daily Net Loss	$ 45
Superior Trader's Daily Net Gain	251

Data Brad M. Barber, Yi-Tsung Lee, Yu-Jane Liu, and Terrance Odean *BusinessWeek*

"But there's a small population that makes a ton of money.

The researchers began by counting some 925,000 individual investors on the exchange in a typical month. Th then identified the heaviest traders, a group that was just 1% of the total but accounted for more than half of all individua day-trading volume. They bought and sold stocks at a profit most days, but after transaction costs lost money. As for dabblers, the less they traded the more often they lost.

In a second cut of the data, the researchers checked to see past winners kept winning. They ranked all traders by their success over the prior six months and then split them into s groups. The top-performing group went on to see average daily gains of $251, even after costs (table). At annual rates, that comes to more than five times the annual per capita income in Taiwan. The second-best group also netted gains, but just $48 a day, while the third group lost money, the fourth did worse yet, and so o

The odds—82% of traders lose—are so grim that Barber encourages no one to da trade. Yet it seems not everyone who does is a fool. Left for future researchers is wh strategies—trading just a stock two, say—are winners. Meantime, we can form our own notions about what works. Here's or you might see on *Jeopardy!* Category: Wa Street Animals. Answer: Neither bull nor bear, they're quick as cats and work like dogs to become wise as owls. Question: Who are successful day traders? ■

E-mail: rb@businessweek.co

BY GENE G. MARCIAL

HIGH OIL PRICES ARE HIKING DEMAND FOR PATTERSON-UTI'S RIGS.

DELAWARE CASINO DOVER DOWNS COULD BE RIPE FOR A BUYOUT.

ÆTERNA ZENTARIS' CANCER DRUGS MAY SOON START TO PAY OFF.

'atterson: Really Drilling

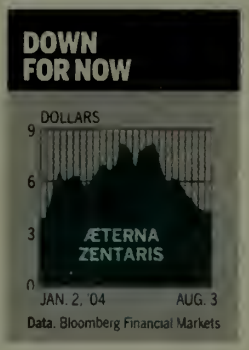
HARES OF PATTERSON-UTI Energy (PTEN) have sprung up since early June, when they dipped to 14 after a poor second quarter. Stock in the No. 2 provider of onshore-lling services to oil-and-gas producers is now at 17.36—and ne pros see it hitting 25. "Drilling ivity is on the cusp of a dramatic ve-up, to a point where Patterson ld raise day rates," says William rnisch, chairman of Forstmann-Leff sociates, which owns shares. mand for drilling gear has bumped lately, reflecting increased spending the big producers, notes Harnisch. he rig count could hit the high levels n in the third quarter of 2001," he ls. Patterson has 361 rigs, mainly in w Mexico, Oklahoma, Texas, Utah, d western Canada. Today's high prices for crude are partly ving the hike, says Harnisch. Magnus Fyhr of broker feries says the stock is "attractively valued" at 15.5 times his 05 earnings forecast of $1.09 a share. His 2004 estimate is ¢, vs. 2003's 34¢. Fyhr rates Patterson a buy, with a 12-nth target of 25. Harnisch says earnings could soar to $3 if oming demand for rigs outstrips supply. If that happens, he s, the stock could easily shoot up to 35.

re Rivals Giving Dover he Once-Over?

BIG BOARD-LISTED Dover Downs Gaming & Entertainment (DDE) has everything major casinos want, and some players believe that this "racino" is ripe a takeover. Spread over 78 acres in Delaware, Dover has the rks: Dover Downs Slots, a casino packed with slot chines; Dover Downs Raceway, a ⅝-mile harness track; and uxury hotel. Mike Snyder of Gabelli Asset Management, ich has an 8% stake, says some casino operators, such as rrah's Entertainment, or other racinos like MTR Gaming oup, would find Dover attractive. Harrah's, which is buying esars Entertainment, has stated it is looking to acquire a ino. MTR owns and runs Mountaineer Racetrack & Gaming sort in West Virginia. In a buyout, Dover, now at 9.77, is rth 15, figures Snyder. It was spun off by Dover Motorsports March, 2002. So the two years, which Internal Revenue rvice rules require before a tax-free spin-off can be bought out, have elapsed. Dover's slot casino is now managed by Caesars. Dover may not renew the contract, which expires in December. That could be more reason for Harrah's to buy Dover. Jeff Martin of Roth Capital Partners, who rates Dover a buy, sees earnings of 70¢ a share in 2004, on sales of $207.2 million, and 85¢ in 2005, on $214.5 million. Dover, Harrah's, and MTR did not return calls for comment.

Profits Loom For Æterna Zentaris

A LITTLE-KNOWN Canadian biopharma with the exotic name of Æterna Zentaris (AEZS) has an array of cancer products that could push it to profitability after years of losses. Jeffrey Kraws, CEO of Crystal Research Associates, says Zentaris is generating promising new drugs. Two of them: Cetrotide, which is in clinical trials for use on uterine tumors and enlarged prostates and which is already being sold to aid in-vitro fertilization—and Impavido, which is in trials for use on parasitic skin disease. It is already used in India for an infectious disease called Black Fever. Mark Knapp of securities firm LOM in Toronto says one product in the pipeline, Perifosine, is in trials for breast, prostate, and head and neck cancers. Rating Zentaris a buy, he sees the stock, now at 4.15, reaching 12 in a year. David Martin of Dundee Securities in Toronto says Zentaris has already yielded operating earnings this year. Its 62%-owned Atrium Biotechnologies unit makes cosmetics and nutritional products for Chanel, Aventis, and Nestlé, among others. Atrium should post sales of $137 million and operating earnings of $15 million in 2004, says Zentaris CFO Dennis Turpin. He figures Zentaris will post 2004 revenues of $168 million and operating earnings of $11.4 million.



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/ today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays. See Gene on Fridays at 1:20 p.m. EST on CNNfn's *The Money Gang*.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor their firms hold positions in the stocks under discussion. Similarly, they have no investment banking or other financial relationships with them.

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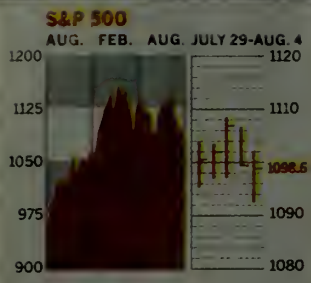


COMMENTARY

Despite heightened U.S. security alerts and a rousing acceptance speech by Democratic candidate Kerry, profits—not politics—drove the bourses. Procter & Gamble cleaned up, with quarterly profits soaring 44% from a year ago. Still, investors are trying to read the tea leaves, though earnings have come in strong. The big worry? Rising oil prices, which are putting a damper on spirits.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	AUG. 4	WEEK	% CHANGE YEAR TO DATE	LAST 12 MONTHS
S&P 500	1098.6	0.3	-1.2	11.8
Dow Jones Industrials	10,126.5	0.1	-3.1	10.2
NASDAQ Composite	1855.1	-0.2	-7.4	8.2
S&P MidCap 400	571.5	0.1	-0.8	16.6
S&P SmallCap 600	276.3	0.5	2.2	21.3
Russell 3000	619.4	0.3	-1.7	12.0
SECTORS				
BusinessWeek 50*	630.4	0.2	1.3	10.0
BW Info Tech 100**	321.9	-0.3	-8.1	3.6
S&P/BARRA Growth	538.4	0.2	-3.2	7.9
S&P/BARRA Value	556.2	0.4	0.8	15.7
S&P Energy	256.8	0.3	14.6	36.3
S&P Financials	376.0	0.5	-1.0	11.3
S&P REIT	122.5	3.7	5.8	18.2
S&P Transportation	200.2	1.4	-0.8	13.3
S&P Utilities	123.8	2.7	4.5	18.9
GSTI Internet	133.4	-4.0	-7.8	5.2
PSE Technology	661.0	0.1	-5.2	11.6

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	AUG. 4	WEEK	% CHANGE YEAR TO DATE	LA MO
S&P Euro Plus (U.S. Dollar)	1130.3	0.5	-4.1	
London (FT-SE 100)	4408.1	1.2	-1.5	
Paris (CAC 40)	3607.6	0.9	1.4	
Frankfurt (DAX)	3823.7	0.4	-3.6	
Tokyo (NIKKEI 225)	11,010.0	-1.7	3.1	
Hong Kong (Hang Seng)	12,280.3	-0.3	-2.4	
Toronto (S&P/TSX Composite)	8363.0	0.1	1.7	
Mexico City (IPC)	10,075.8	-0.1	14.6	

FUNDAMENTALS	AUG. 3	WEEK AGO	YEA
S&P 500 Dividend Yield	1.69%	1.70%	1.
S&P 500 P/E Ratio (Trailing 12 mos.)	19.7	19.8	27
S&P 500 P/E Ratio (Next 12 mos.)*	16.1	16.0	16
First Call Earnings Revision*	0.16%	-0.30%	0.

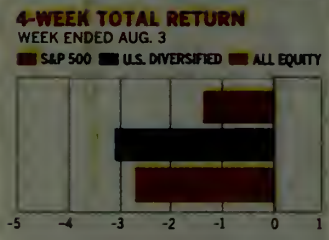
*First Call

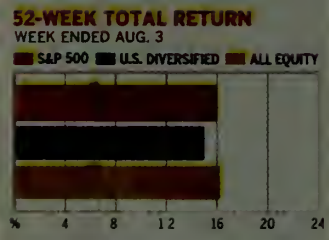
TECHNICAL INDICATORS	AUG. 3	WEEK AGO	REA
S&P 500 200-day average	1107.6	1106.1	Nega
Stocks above 200-day average	50.0%	48.0%	Neu
Options: Put/call ratio	0.70	0.77	Posi
Insiders: Vickers NYSE Sell/buy ratio	3.27	3.57	Nega

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Steel	9.9	Steel	83.5
Tires & Rubber	8.8	Internet Software	81.2
Intgrd. Telecomms. Svcs.	6.1	Oil & Gas Refining	76.9
Specialized Finance	5.1	Fertilizers & Ag. Chems.	65.4
Photographic Products	3.0	Tires & Rubber	60.3

WORST-PERFORMING GROUPS	LAST MONTH %		LA MON
IT Consulting	-24.2	Airlines	-
Casinos	-18.1	Semiconductor Equip.	-
Internet Software	-17.3	Health-Care Distributors	-
Internet Retail	-17.0	IT Consulting	-
Instrumentation	-15.6	Biotechnology	

MUTUAL FUNDS





Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Latin America	3.0	Natural Resources	43.5
Natural Resources	2.2	Latin America	37.7
Utilities	1.5	Japan	33.7
Real Estate	0.6	Real Estate	25.5
LAGGARDS		**LAGGARDS**	
Technology	-7.6	Technology	5.9
Small-cap Growth	-6.5	Health	9.1
Health	-5.9	Large-cap Growth	9.3
Mid-cap Growth	-5.2	Domestic Hybrid	10.9

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFds. USh. Sm. Cap Inv.	10.1	State St. Rsch. Gl. Rs. B	67.2
ProFunds UltSh. OTC Inv.	9.1	ProFunds Energy Usr. Inv.	66.1
Rydex Dynam. Vent. 100	9.0	ProFds. Wrlss. Ultsr. Inv.	63.4
ProFds. UltTelcmms. Inv.	7.0	iShares MSCI Austria Idx.	60.9
LAGGARDS		**LAGGARDS**	
ProFds. Intnet. Ultsr. Inv.	-19.0	Rydex Dynam. Vent. 100	-28.8
Royce Technology Value	-18.1	ProFunds UltSh. OTC Inv.	-28.8
Reynolds	-17.1	Ameritor Investment	-27.8
Amerindo Technology D	-16.4	Rydex Dyn. Tempest 500	-27.4

INTEREST RATES

KEY RATES	AUG. 4	WEEK AGO	YEAR
Money Market Funds	[illegible]	[illegible]	[illegible]
90-Day Treasury Bills	1.48	1.45	0.9
2-Year Treasury Notes	[illegible]	[illegible]	[illegible]
10-Year Treasury Notes	4.43	4.59	4.2
30-Year Treasury Bonds	[illegible]	[illegible]	[illegible]
30-Year Fixed Mortgage †	5.97	6.14	6.3

†BanxQuote

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BON
General Obligations	[illegible]	[illegible]
Taxable Equivalent	5.47	6.8
Revenue Premium Bonds	[illegible]	[illegible]
Taxable Equivalent	5.71	7.

THE WEEK AHEAD

PRODUCTIVITY & COSTS *Tuesday, Aug. 10, 8:30 a.m. EDT* » The rise in output per hour worked during the second quarter probably improved by 2.8%, after growing by 3.8% in the first period. That's based on the median forecast of economists surveyed by Action Economics. Unit labor costs probably picked up by 1.7%.

FOMC MEETING *Tuesday, Aug. 10, 9 a.m. EDT* » The Federal Reserve Board's Open Market Committee will meet to set monetary policy. Economists surveyed by Action Economics expect the Fed will hike rates to 1.5%, from the current 1.25%.

RETAIL SALES *Thursday, Aug. 12, 8:30 a.m. EDT* » July retail sales most likely grew by 0.7%, following a 1.1% drop in June. Excluding autos, sales probably rose by 0.3%, after dipping 0.2%.

PRODUCER PRICE INDEX *Friday, Aug. 13, 8:30 a.m. EDT* » Producer prices during July likely moved up 0.2%, after a 0.3% drop in June. Even after excluding food and energy, core prices are expected to have grown by 0.2%, after a 0.2% rise in June.

INTERNATIONAL TRADE *Friday, Aug. 13, 8:30 a.m. EDT* » The July foreign trade deficit probably widened to $47.5 billion. In June, a record level of exports helped narrow the monthly trade gap to $46 billion.

The *BusinessWeek* production [illegible] climbed to 223.9 for the week [illegible] July 24, up 11.7% from the p[illegible] year. Before calculation of the [illegible] week moving average, the [illegible] improved to 223.7.

BusinessWeek onli[illegible]

For the BW50, more investmen[illegible] data, and the components of the production index visit www.businessweek.com/magazine/extra

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s index gives the starting page for a story or feature with gnificant reference to a company. Most subsidiaries indexed under their own names. Companies listed only ables are not included.

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How to Combat Global Warming

Say "global warming" in Washington, and you set off a firestorm of ideological outrage. Conservatives see global warming as a hoax designed to limit growth and expand government. Liberals see an imminent catastrophe that demands drastic action. The truth, as usual, is more complicated. Though we don't know the long-term consequences, we do know that the world is warming—the '90s were the warmest decade in centuries. We know that businesses can save money and increase efficiency by cutting energy costs. And we know that a national policy that cuts fossil fuel consumption converges with a geopolitical policy of reducing energy dependence on Middle East oil. Reducing carbon dioxide emissions is no longer just a "green" thing. It makes business and foreign policy sense, as well (page 60).

Agreeing on how to cut fuel use and CO_2 emissions is another matter. Companies such as BP and DuPont are using "cap-and-trade" systems to set up internal corporate markets in emissions permits. They are building on the successful Clean Air Act, which reduced acid rain by lowering sulfur dioxide emissions from utilities through a similar cap-and-trade system. The Kyoto Protocol was supposed use a global cap-and-trade system to curb CO_2 worldwide—but failed to impose carbon constraints on China, India, and other fast-growing countries. China's oil imports alone are up sevenfold since 1998, and the country is now one of the world's biggest air polluters. If any emission-trading system is to work, China must be part of it. Europe, for its part, is going ahead with a cap-and-trade system that all global corporations will soon have to address. Intel, for example, is researching new chemicals to replace PFCs which are potent greenhouse gase

In the end, the only real solution may be new energy technologies. There has been lit innovation in energy since the internal combustion engine was invented in the 1860s and Thon Edison built his first commercia electric generating plant in 188 Now, General Electric is investi in wind and solar technologies, and the Bush Administration is putting several billion dollars in hydrogen-based energy systems General Motors is working on hydrogen-powered cars, but Detroit trails Japan in technolog such as electric-gas hybrids.

In the end, the only real solution may be new energy technologies

Any serious attempt to shift from fossil fuels to alternative energy demands greater national and global efforts. Nuclear the one new energy technology that held so much promise i the '60s and '70s, deserves a second look. New reactor desig are safer and cheaper. Dealing with nuclear waste, however, awaits a solution.

The good news on global warming is that individual corporations are taking their own steps to curb CO_2 emission because it makes business sense. Detroit, for its part, could d lot more to raise fuel efficiency, perhaps with help from Washington in the form of tax credits for hybrids. And short a global agreement, individual states are taking the lead in demanding reduced emissions. Washington would do well t step up before companies are faced with 50 different standar

Few dispute the actual science of global warming today. Reasonable people are beginning to act on it.

Mowing Down Farm Subsidies

The U.S., Europe, and Japan spend $300 billion a year to subsidize farmers. These subsidies, by distorting international markets, crush the cotton growers of Pakistan, the rice farmers of Indonesia, and millions of other people throughout the Third World. They destabilize some of the very nations the U.S. needs in the fight against Islamic fundamentalism and al Queda terrorism. That's why the recent World Trade Organization agreement that promises to curb export subsidies for agriculture is a very welcome step. Hats off to U.S. Trade Representative Robert B. Zoellick and European Union Trade Commissioner Pascal Lamy for restoring credibility to the principle of free trade and for giving the farmers of developing countries the break they deserve to participate fairly in the global economy.

Of course, the real work remains to be done. No date has yet been set for nations to remove their export subsidies. Countries are also supposed to start cutting their productio subsidies, but no date has been set for that, either. The WTC has already ruled that the U.S. should cut its subsidies for cotton by 20%, and Washington says it will comply. But the are few details of further cuts on other agricultural product In return for agreeing to cut subsidies, Zoellick won a pledg that American farmers would be granted greater access to high-tariff markets. That too remains to be seen.

The next round of trade talks will be the toughest. The French are already making noises that undermine the latest agreement. The Indians remain suspicious of U.S. intention And support for free trade in the U.S. isn't solid, especially among Democrats. But for the first time in decades, a more level playing field for agriculture appears possible.

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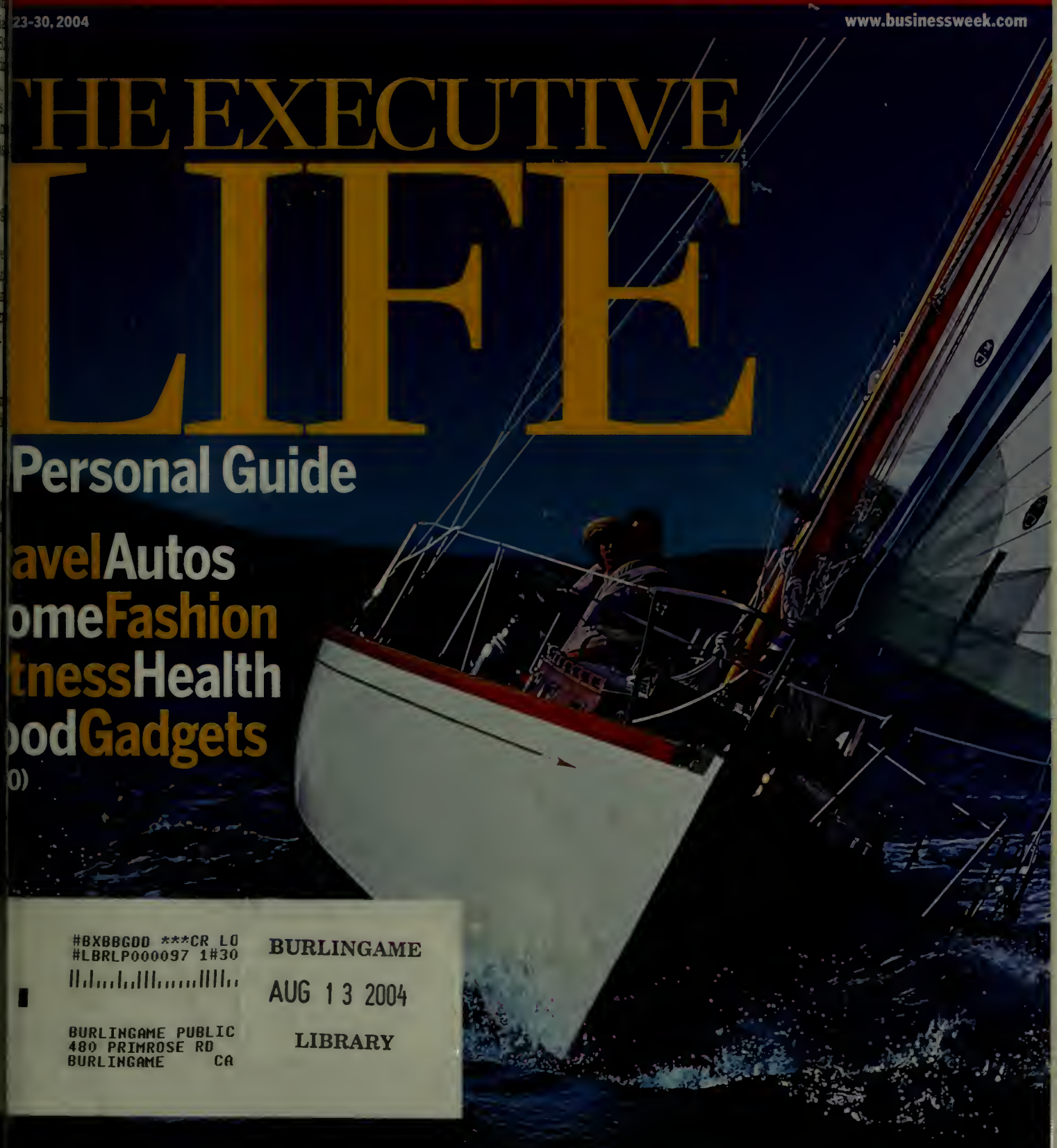

THE EXECUTIVE LIFE

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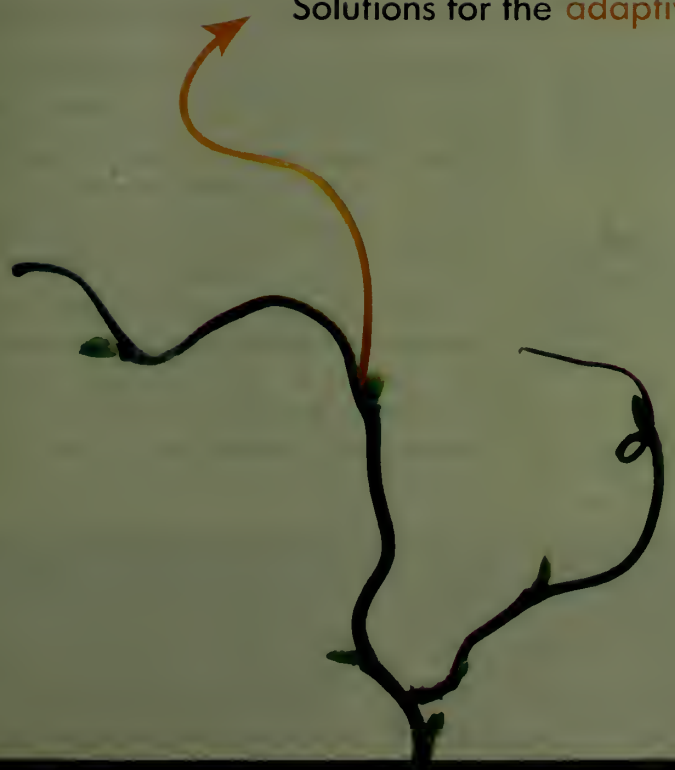

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WHY INDUSTRY LEADERS EVERYWHERE ARE TAKING A CLOSER LOOK AT PERFORMANCE MANAGEMENT.

It's a lesson every successful executive knows by heart: link strategy and execution, and the company profits. Today, more and more organizations are accomplishing this goal by implementing an enterprise-wide performance management strategy.

Not to be confused with ERP, CRM or similar enterprise systems, the benefits of performance management are easy to see. When everyone is on the same page, they more effectively address problems and maximize opportunities. Just think, in a small company, there's a direct path between the executives who set strategy and the people who carry it out. In a large company, that strategy is filtered through layers of directors, managers and others before hitting the front lines. This can create a disconnect that stands in the way of success. That's where a well thought-out performance strategy, combined with performance management solutions comes in.

PRIORITY ONE: BRIDGING THE PERFORMANCE GAP.

To illustrate this point, we'll look at the three most common contributors to the performance management gap: Lack of alignment. Decision paralysis. And inflexible budgeting.

SOLVE LACK OF ALIGNMENT WITH A COMMUNICATED FOCUS.

Robert Kaplan, one of the co-founders of the Balanced Scorecard, tells this story about a major American oil company. It knew that its scorecard was working when employees driving the oil trucks started to call.

They phoned in to say they had just delivered fuel to a company gas station and the bathrooms were a mess, the lights in the company sign were out, and customers weren't being serviced properly.

The same truckers had been delivering gas to the same stations for years. What was different?

The truckers now knew that the company's strategy hinged on exceptional customer service and customer care. And that it was their responsibility to point out where strategy and action didn't line up.

Lesson: Priorities should be clearly communicated to everyone in your organization. Make it happen with scorecards matched with enabling technologies.

BASE CHOICES ON A COMMON LANGUAGE TO ELIMINATE DECISION PARALYSIS.

"Nothing frustrates senior management more than executives coming to meetings with reports and suggestions based on data that doesn't match up," says David Folger, VP of enterprise analytics at META Group.

To avoid decision paralysis, it's important to remember that you invested in data warehouses to store data, not report on it. What's needed, says Folger, is an overhaul to companies' approach to enterprise reporting. "Senior management needs one version of the truth."

Lesson: Unlocking the value of your corporate data lets people take intelligent and fact-based action on your priorities. The key? Unified rather than siloed reporting and analysis.

REPLACE INFLEXIBLE BUDGETING WITH AN ADAPTABLE AND CONTINUOUS PROCESS.

Jack Welch, former CEO of General Electric, once famously said, "The budget is the bane of corporate America."

The problem, of course, is budgeting and planning as an event. The better approach, experts say, is a continuous process that engages people at the point of impact and lets them adapt plans and budgets as conditions change.

Of course, this agility means moving beyond simple spreadsheets. Through planning technology, people can adjust forecasts in real time. And gain immediate visibility into potential growth drivers and problems. Planning, budgeting, and forecasting this way makes the future more predictable. And the market rewards better predictability.

Lesson: Implementing more dynamic, driver-based planning makes you more agile as conditions change.

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CEO	*Directive*	• Retain our most profitable customers
VP of Sales	*To do*	• Define most profitable customers, break down by region • Look for common traits: size, industry, location, products • Prepare prospecting lists based on these traits • Adjust sales forecasts based on new market opportunity
	Directives	• Retain our most profitable customers as listed • Win 30% of the prospecting accounts
Regional Manager	*To do*	• Look for trends in products, service issues, and shipping • Based on trends, encourage reps to sell Product X because it is clearly more profitable, even though Product Y is the revenue leader • Adjust rolling forecast to reflect increased demand for Product X Manufacturing will see this forecast change and plan accordingly
	Directives	• Retain our most profitable customers using list • Get us in 40% of new prospect accounts • Lead with Product X
Sales Rep	*To do*	• Request to be flagged when any trouble tickets open on listed customers • Analyze my existing accounts to see how I can make them more like the most profitable ones • Make the calls and sell

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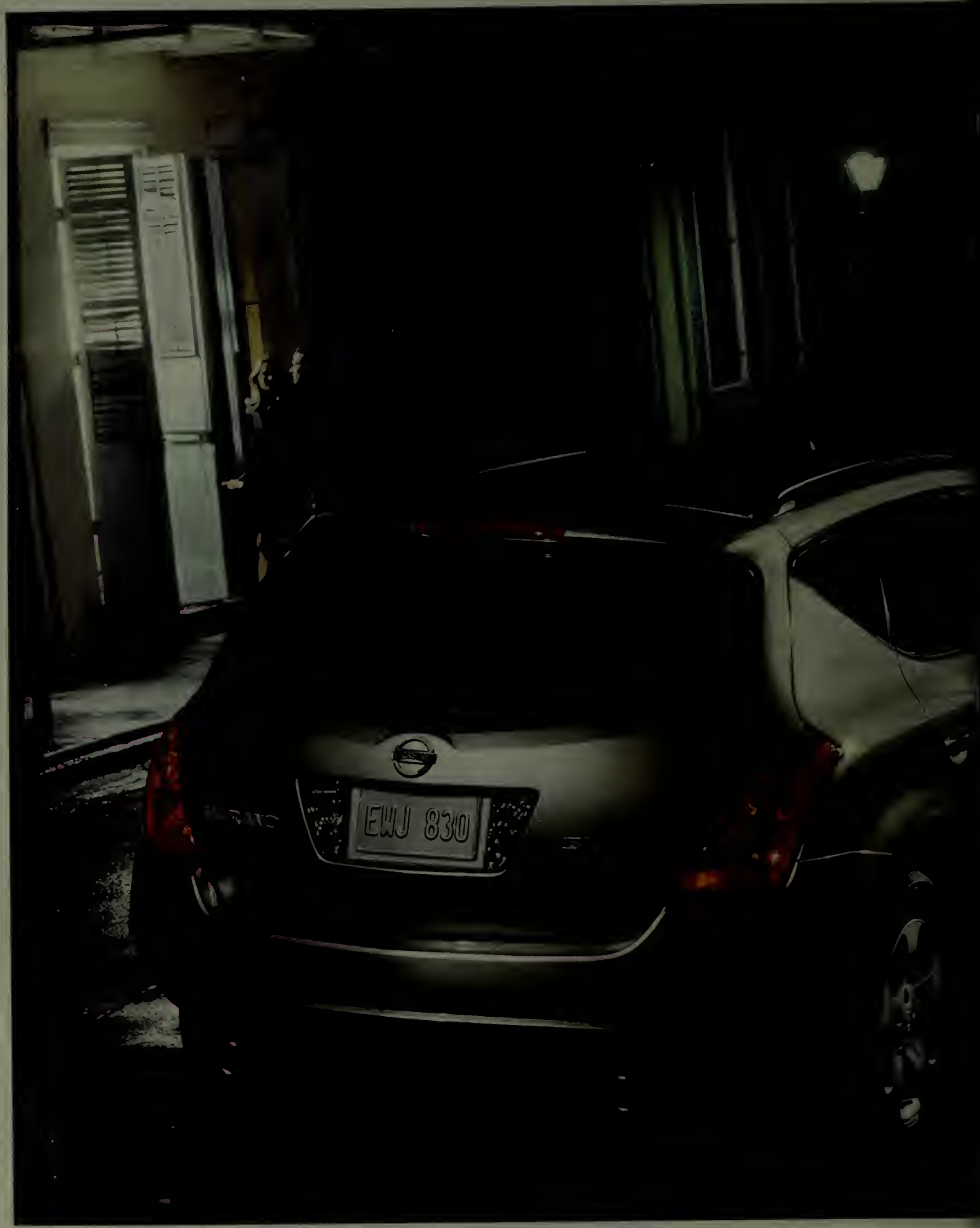

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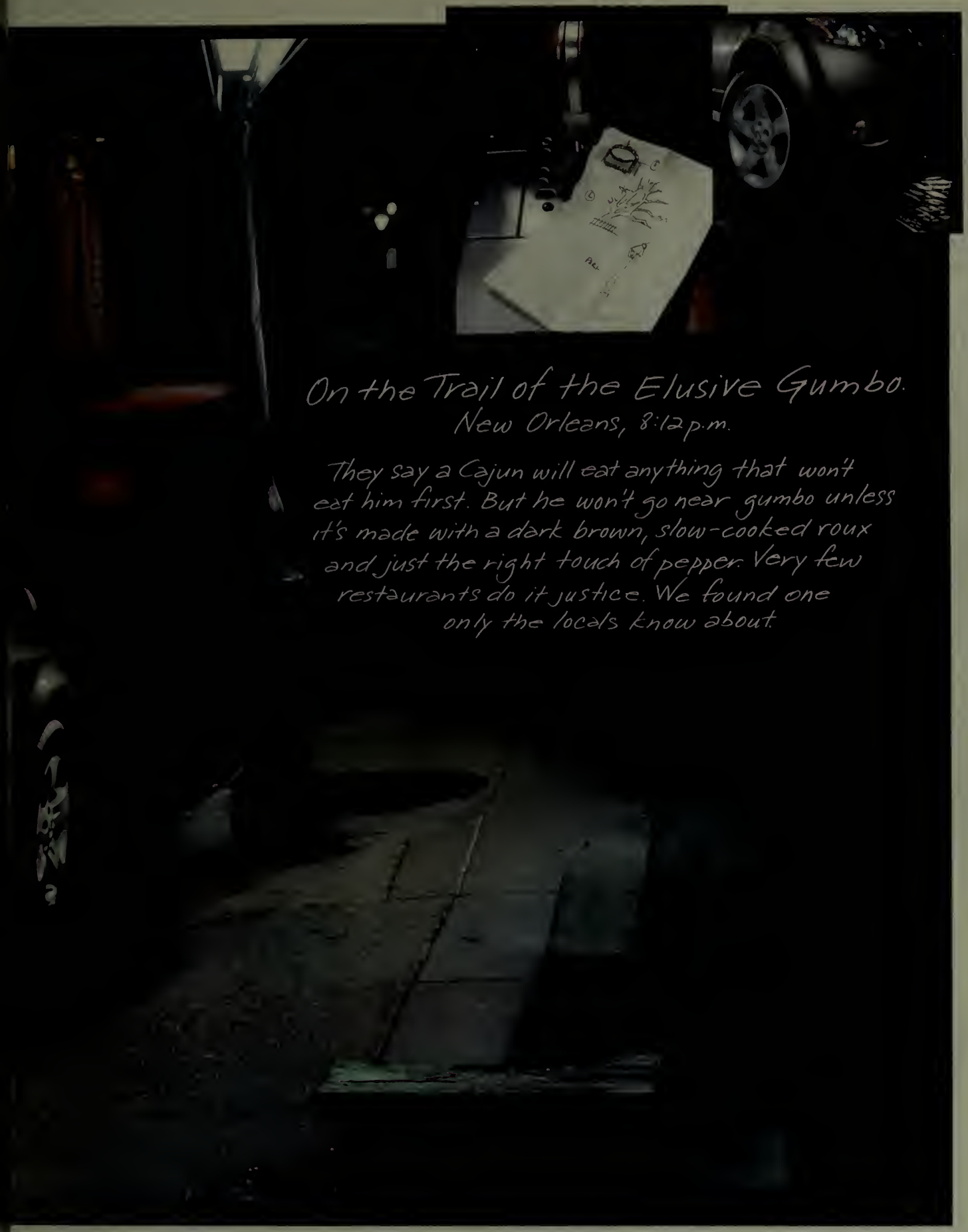

On the Trail of the Elusive Gumbo.

New Orleans, 8:12 p.m.

They say a Cajun will eat anything that won't eat him first. But he won't go near gumbo unless it's made with a dark brown, slow-cooked roux and just the right touch of pepper. Very few restaurants do it justice. We found one only the locals know about.

NISSAN

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- THE WALL STREET JOURNAL

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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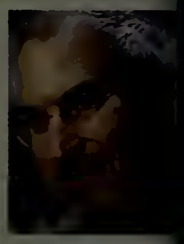
Technology Special Report: Apple's Sweetness Regained

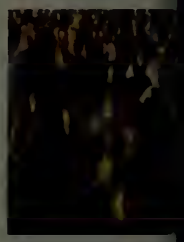


It's making healthy sales gains in schools, corporations, and the government sector—without the benefit of an iPod halo effect. Plus: breaking into the supercomputer biz, and Steve Jobs's cancer scare

The Chatter About Citi and Barclays

After recent megamerger deals in banking, markets have been abuzz about what Citigroup's next move might be. Both Citi and Barclays are widely believed to be in the mood for a merger. Will it be with each other, or could they have other targets in mind?

The American Workforce: Diverse, Not Divided



Contrary to popular belief, the U.S. is not hopelessly divided. The workplace has become America's melting pot, and that exposure to difference and tolerance is a powerful economic force

The A-B-Cs of Google's Auction

It's certainly not your usual initial public offering. Standard & Poor's Scott Kessler provides a guide to investor questions about the search company's IPO auction, along with S&P's view on the best bidding price and strategy

Will Patent-Violation Fears Freeze the Penguin?

The city of Munich will delay switching to Linux over legal concerns. But this likely won't stop European outfits' open-source conversion

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UP Front

"Most CEOs I talk to have put a little bit of caution on their optimism and termed it 'moderate growth.'"
–John Chambers, CEO of Cisco Systems (page 56)

TED BY IRA SAGER

NAY PATROL

AHOO GETS DU COMING ND GOING

OO! IS QUICK to paint itself ne of the Web's good s. So on Aug. 4 it unveiled i-Spy, a free gram that omatically ts down rious ware, uding so-ed adware—esdropping grams that onto PCs serve up a ry of oft-oying pop-ads. But t CEO Terry el doesn't g about: Yahoo also pens to be one of the vare industry's biggest ncial backers.

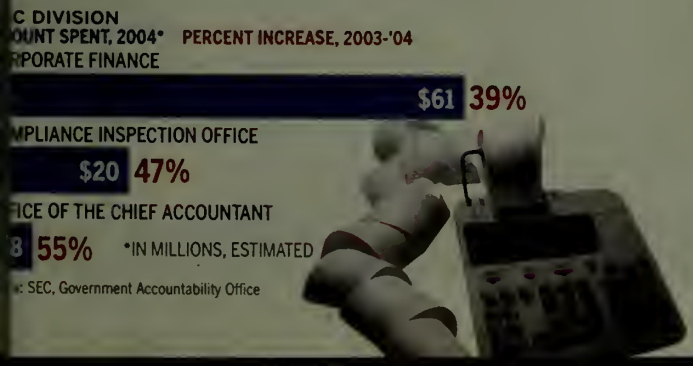
SEMEL Mum on adware

Yahoo's partner is adware kingpin **Claria,** formerly known as Gator. Claria's pop-up ads pelt the computer screens of 43 million people worldwide, and they often contain links to Yahoo's search advertisers. Yahoo, which divvies up the advertising fees with Claria, is the only major search engine that has teamed up with an adware outfit. Last year, the deal generated $28 million, nearly one-third of Claria's sales, according to filings for its postponed initial public offering.

Yahoo says it has no intention of changing its dual approach and insists it's trying to improve customer choice. Deluged Web surfers may want to hold their applause. *–Ben Elgin*

HE BIG PICTURE

NEW WORLD OF ENFORCEMENT In its ojected budget, the SEC has boosted ending on investigations of accounting fraud d oversight of new financial disclosures:



CHARITY CASES

Nonprofits Under The Microscope

REGULATORS ARE TURNING THEIR eyes to the nonprofit world. On Aug. 10, the **Internal Revenue Service** announced a sweeping probe of 2,000 tax-exempt groups, looking into pay and insider deals. The IRS won't say who's on the list, but those with execs drawing more than $1 million could be audited.

Such sums are usually paid to the top execs at universities and hospitals, but a *BusinessWeek* analysis finds many other charities and nonprofits cross that threshold, too. For instance, according to tax filings, the CEO of **Normative Services,** a Sheridan (Wyo.) home for troubled youth, received $1.2 million in 2002. And in 2001, the vice-president of **Good Companion Broadcasting,** a Hagerstown (Md.) religious media outfit, took home $2.4 million. Neither group returned calls for comment.

Meanwhile, the Senate Finance Committee is probing the **Statue of Liberty-Ellis Island Foundation** for alleged abuses. Among them: consulting contracts received by its CEO and its fund-raising tactics. A spokesperson says policies are being "refined." IRS advisory board director Victoria Bjorklund says: "The public needs confidence in charities." It helps that the IRS has threatened stiff penalties, and, in extreme cases, removal of organizations' tax-exempt status. *–Jessi Hempel*

UP Front

ELECTION 2004

USING THE WEB THE WAY DEAN DID

ALTHOUGH HOWARD DEAN won only one primary—in Vermont, his home state—he raised $21 million online, and used e-mail, Web logs, and Web-organized meetings to build grassroots support. Now, Washington upstarts **EchoDitto** and **Blue State Digital**—founded by ex-Deaniacs—aim to do the same for other Democratic candidates and causes.

EchoDitto's founder, former Webmaster Nicco Mele, 26, is using the Web to raise funds and create a blog for Barack Obama, the Senate hopeful from Illinois. And the **Service Employees International Union** tapped it to design a recruitment site.

Blue State Digital, started by four other Dean campaign tech staffers, did the redesign for Dean's **Democracy for America** site and an online organizing tool for the liberal 527 group **America Coming Together.**

Lessons from Dean's flameout aren't lost on the consultants. "The Internet by itself isn't going to win you an election," says Blue State co-founder Joe Rospars, 23. But come this November, Dean's campaign could have quite an impact after all. *–Mark Walsh*

PRODUCT PEEK

PENETRATE THIS, WI-FI SPIES It's not the stuff that lines your kitchen. A new wallpaper, made by British defense contractor BAE Systems, purports to keep companies' wireless network secure. The "paper"—made of thin sheets of copper and plastic—blocks Wi-Fi signals from leaving buildings but lets cell-phone calls through. Previous measures—aluminum-lined walls and signal-canceling glass in windows—blocked cell phones. Thus, they held back the spread of Wi-Fi networks in large corporations. BAE hasn't started selling the wallpaper but says it will cost as little as $300 to screen one floor of an office building. A small price to keep out prying eyes. *–Jasper Perkins*

BOTTOMS UP

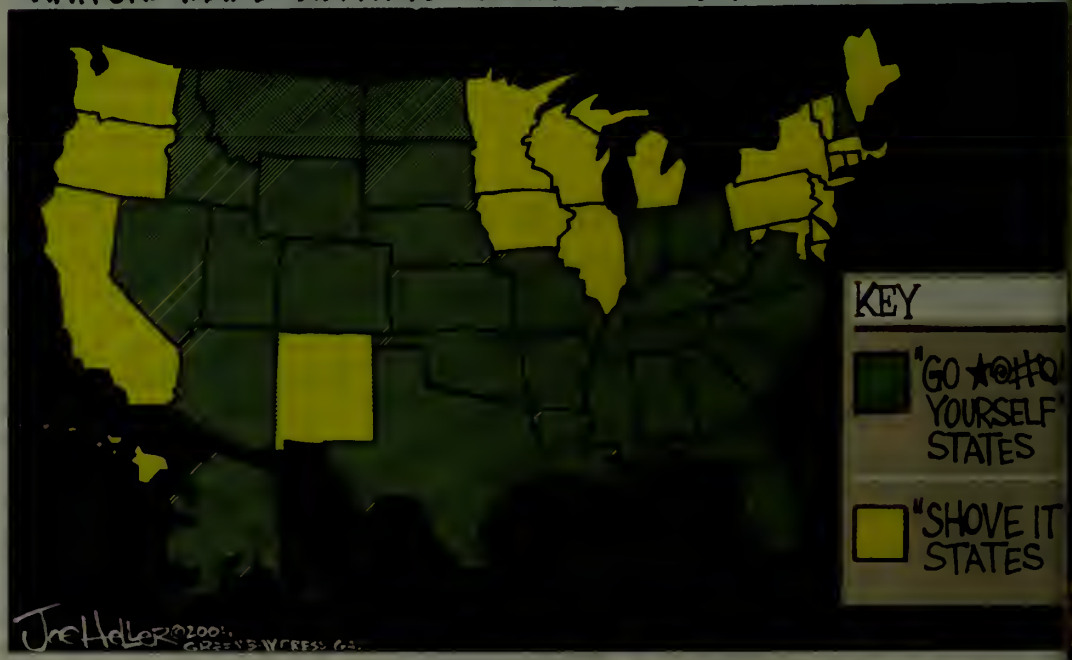
BINGE DRINKING ON THE STREET

THE IRAQ WAR drove Wall Street to drink, says Dr. Alden Cass. In a July 28 study, the president of consultancy **Catalyst Strategies Group** says that during and just after the war, 32% of his 151 respondents—mostly brokers and analysts—had six or more drinks on at least one occasion a week.

While traumatic events often lead to drinking problems, Cass says that bankers took to the bottle earlier than usual because of "open wounds" from September 11. It may be time to consider more healthful coping skills. *–Jessi Hempel*

DRAWN & QUARTERED

A NEW ELECTION MAP REPLACING THE OLD RED STATE/BLUE STATE KEY WITH ONE THAT BETTER REFLECTS THE TONE OF THE 2004 CAMPAIGN–



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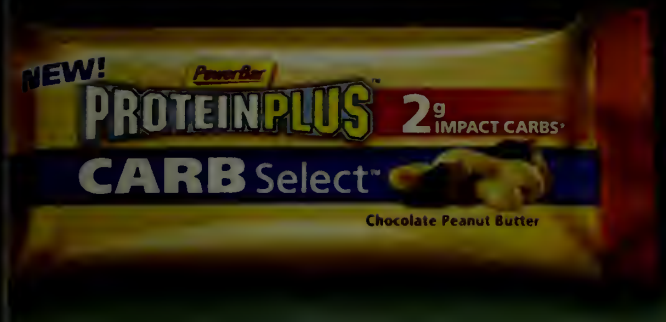

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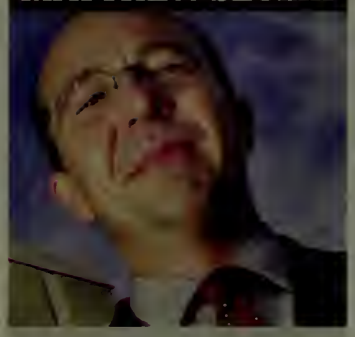
UP Front

FACE TIME

MATTHEW SZULIK



RED HAT: SERVERS OFF THE SHELF

To Red Hat CEO Matthew Szulik, software is a lot like fly fishing. Years ago, says Szulik, who grew up in the fishing port of New Bedford, Mass., fly lures were made by hand and then strung with expensive bait. While some of those craftsmen still exist, they've been overrun by big companies that can produce more lures at far lower prices.

Szulik, 47, thinks Red Hat is a company that can drive similar commoditization in software. Red Hat is already the biggest distributor of Linux, the low-cost operating system that competes with Microsoft's Windows and Unix' software.

On Aug. 3, Szulik announced plans to try to commoditize a new market: so-called application servers, which enable big companies to run software programs through-out their computer networks. Red Hat says the application server will be as affordable as its Linux operating system. "The nature of this industry is changing," he says. He'll have time to ponder those changes when he takes his two sons fly fishing. *–Jim Kerstetter*

MEDIA MANIA

CHANNELING ASIA'S KID POWER

CRASH! BANG! POW! Look out, Asia. Here come the Powerpuff Girls, Astro Boy, and SpongeBob SquarePants. This year, four children's channels have appeared in the Asia-Pacific region—**Sony's Animax** and **Playhouse Disney** across Asia, **Viacom's Nick Jr.** in Australia, and a new **Time Warner** offering in India called **Pogo.** A fifth, **Hungama,** begins in India this month. Those join four kids' channels already broadcasting in six languages in the region.

HEADED EAST The Powerpuff Girls (above) and SpongeBob (left)

Behind the explosion: Cable and satellite operators from Seoul to Surabaya are facing new competition. Five years ago, few of developing Asia's 190 million pay-TV subscribers had a choice of operator. Now most countries boast two or more providers, which has led operators to add niche programming. New digital networks—which can handle three to four times as many channels as older analog systems—are also driving the trend.

The next step is beefing up local offerings. This year, roughly 20% of kids' programs in Asia will be homemade, up from 10% four years ago. That trend should continue, although global giants will still dominate the business, as Nickelodeon, Disney, and others start hiring Asian production houses to create programming. For now, content providers are doing just fine supplying Asia with the likes of SpongeBob and Powerpuff Girls—and Asian children are happy to watch. *–Assif Shameen*

CAR NATION

A WHOLE NEW TAKE ON 'FUEL CELL'

THIS WAY TO cheaper gas. A new service for cell phones will allow subscribers to zero in quickly on the cheapest gas around. **Televigation,** a Sunnyvale (Calif.) wireless company, plans to add a "fuel finder" feature to its $9.99 a month direction finder for **Nextel** phones.

The TeleNav fuel finder, slated to be available by the end of August, will locate the lowest gas prices in a desired radius and supply turn-by-turn directions to the cheapest station. Per-gallon gas prices around the U.S. are fed into the TeleNav GPS tracker each day, based on information supplied by the **Oil Price Information Service,** an oil pricing index, and **Wright Express,** a company that processes credit cards for corporate fleets of cars and trucks. Maybe with the money you save, you could start buying premium. *–Seth Porges*

THE STAT

25

The approximate number of U.S. adults, in millions, who have been victims of consumer fraud in the past year, amounting to 11% of the adult population

Data: Federal Trade Commission

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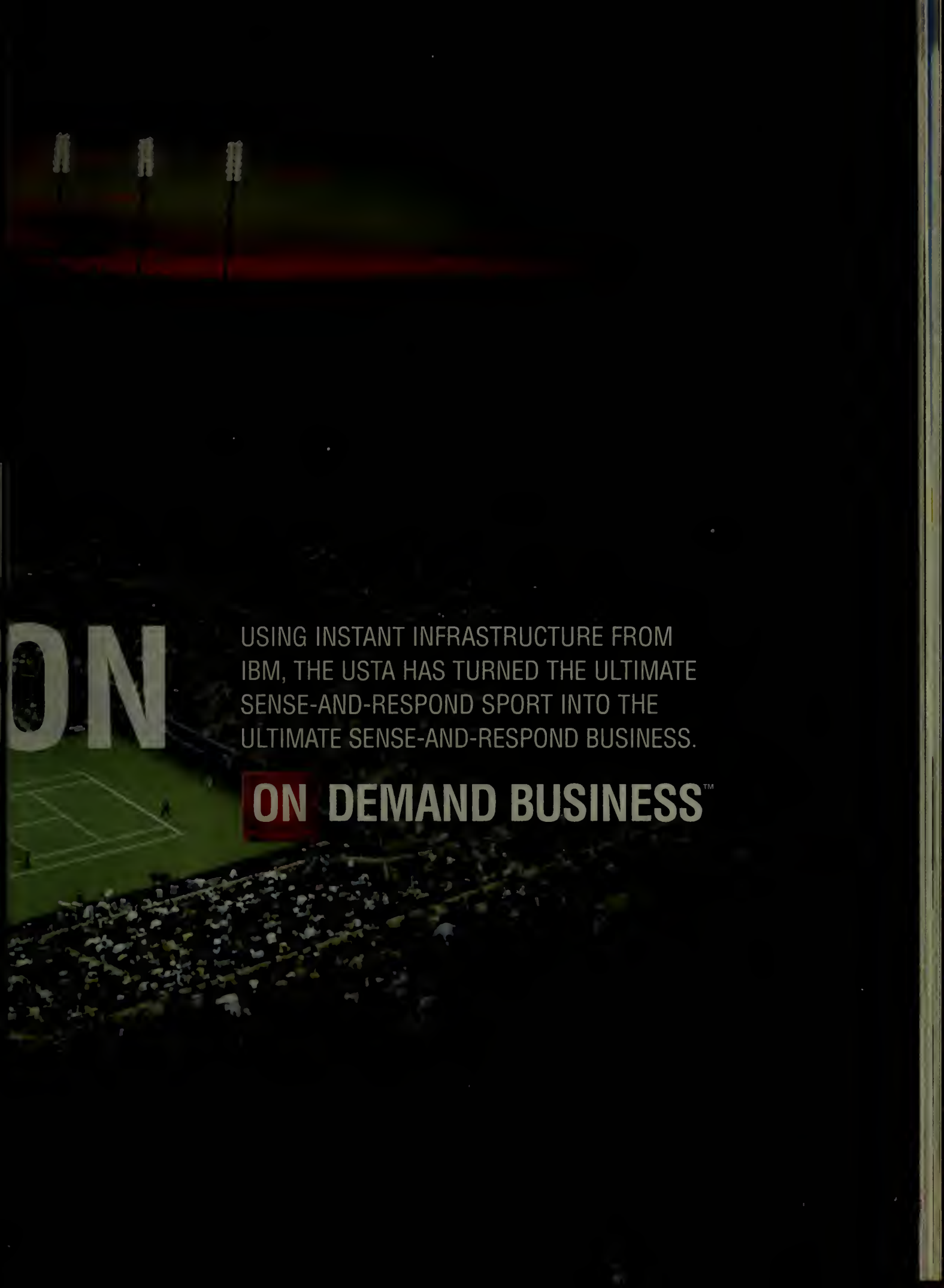
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CELEBRATING 75

As part of its anniversary celebration, BusinessWeek *is presenting a series of weekly profiles of the greatest innovators of the past 75 years. Some made their mark in science or technology; others in management, finance, marketing, or government. In late September, 2004,* BusinessWeek *will publish a special commemorative issue on Innovation.*

The Kings of Quality

IN MAY, SCORES of quality-management luminaries from as far off as Japan and Sweden converged on Stamford, Conn., to pay tribute to a living legend: Joseph M. Juran, the patriarch of quality. The event was billed as "100 years of Juran." He won't turn 100 until the day before Christmas, "but they decided it would be safer not to wait," says Juran wryly.

This year also marks the 50th anniversary of Juran's historic first trip to Japan at the invitation of the Japanese Union of Scientists & Engineers (JUSE). His several visits helped Japanese industry implement "total quality" and shake off its postwar reputation as a maker of cheap, shoddy products. All told, Juran carried his total-quality message to 34 countries on 178 trips abroad, logging more than 5 million air miles by his official retirement in 1994.

JURAN

DEMING

In addition to consulting and lecturing, Juran is a prolific writer. Of his 12 books, the best-seller was originally called *Quality Control Handbook*. Its publication in 1951 prompted JUSE's invitation. The nearly 2,000-page tome, retitled *Juran's Quality Handbook* and in its fifth printing, remains the bible of the quality movement worldwide.

Juran and W. Edwards Deming (1900-93), the two most influential thinkers behind the total-quality movement, both launched their careers a few years apart at Western Electric, which used statistical quality-control techniques pioneered at Bell Labs to build reliable telephones. And both gained acclaim while on loan to the government during World War II. The irony is, Japanese execs heeded the lessons of total quality ahead of American managers.

> The Japanese consider Juran's insights even more important than Deming's

In 1950, JUSE hosted the first of several tours by Deming. His lectures on applying statistical quality control to manufacturing processes—instead of just inspecting products after the fact—were a revelation to the Japanese, and they embraced the concept with religious fervor. JUSE established the prestigious Deming Prize a year later. The U.S. didn't get around to creating its counterpart, the Malcolm Baldrige National Quality Award, until 1987—a decade after Japan began grabbing huge chunks of market share with its well-built cars, TVs and computer chips.

In 1969, JUSE asked Juran to lend his name to Japan's top quality award, a sort of super-Deming Prize for companies that maintain the highest quality for five years running. JUSE deemed Juran's vision of top-to-bottom quality management even more important than Deming's manufacturing insights. Juran demurred—a decision he now regrets. So what could have been the Juran Medal is instead called the Japan Quality Control Medal. There is a Joseph M. Juran Medal, though. It's awarded by the American Society for Quality. Juran personally presented the first one in 2001 to Robert W. Galvin, then head of Motorola Inc.'s executive committee. ■

–By Otis Po

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"When I was in Vietnam . . . there was a phrase that summed up much of the absurdity of the war: 'It don't mean nothing.' "

–Joan M. Maiman
Chicago

SIZING UP JOHN KERRY'S BATTLE PLAN

JOHN KERRY DOESN'T say he plans to raise taxes on the rich, preferring the slick phrase "rolling back" the tax cuts ("Kerry's battle plan," Cover Story, Aug. 2). But whose money is it in the first place? The Democratic Party doesn't wish to recognize that it is the wealthy paying the most taxes to begin with, and someone who paid zero taxes is obviously not going to get a tax break.

There are two ways to view this: You can view a tax break either as a "gift" from the government, or that going forward they will "steal" less of your hard-earned money so that you can spend it as you wish. Using the phrase "rolling back" implies that Kerry views the tax cut as a gift from the government.

It's not the government's money—it's your money. Let's not forget that.

–Benjamin M. Zeloof
Bridgewater, N.J.

YOUR COVERAGE of Democratic Presidential hopeful John Kerry raises the issue of Kerry's use of his military service in Vietnam as a campaign asset. I find this use of wartime service confusing at best.

While Senator Kerry has surround himself with a made-for-photo-ops vet ans crew at public gatherings, he select a man with no military experience, Sen tor John Edwards, as his running ma and supported a keynote address by fo mer President Bill Clinton, whose ov lack of military service was a major iss during his election campaign.

When I was in Vietnam, where I serv as a Red Cross hospital worker in the ea ly 1970s, there was a phrase that summ up much of the absurdity of the war: ' don't mean nothing." That could be sa today of Mr. Kerry's selective devotion the armed forces and veterans.

–Joan M. Maim
Chica

IMPORTING EUROPE'S WOES TO AMERICA?

THE TROUBLES OF EUROPE will becon the troubles of the U.S. if the Democra and labor unions get their way ("Europ Staring into the abyss," Economic Vie point, Aug. 2). Europe's answer to t problem, of course, has been to attempt hobble the U.S. with the same kinds of s cial burdens it faces. Europe has disco ered the price it has to pay for the failu

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to have responsible government. Democrats have not. Once trained to expect more of the same, Europeans' ability to change is most unlikely.

Let me see: Was Margaret Thatcher more similar to the Republican (maybe the conservative Republican) model or the Democratic "give them anything they want" model? The notion of robbing Peter to pay Paul, while earning Paul's undying support, results in today's Europe. Soon the U.S. may only have the productive Peters paying the bills. That is when the demise of democracy and capitalism accelerates.

–Don R. Sherwood
Boulder, Colo.

ARE BRANDS CULTS—OR ARE THEY JUST BRANDS?

I BUY COKE because I like its taste—and not the taste of Pepsi or Mountain Dew, which I have tried ("Cult brands," Special Report, Aug. 2). I couldn't care less about brand. I buy Apple Computer Inc. machines because they are far more user-friendly than PCs. If PepsiCo Inc. and Microsoft Corp. improved their products, I would switch back to them. Brand is garbage; performance is everything.

–Donald E. Brown
Fairfax, Va.

INFLATION IS SQUEEZING RETIREES, TOO

WHILE YOUR AUG. 2 editorial "The real middle class squeeze" correctly analyzes the effect of the "core" inflation on the median family whose income is up 8% from 2000 to 2004, it completely neglects to mention the dramatic effect of the "middle" inflation on the ever-increasing group of retirees.

–L.J. Fanta
DeBary, Fla.

THE NEW MEDICARE LAW NEEDS NEGOTIATING MUSCLE

"WHY THE GOP has a Medicare headache" (Washington Outlook, July 26) is not up to your usual standards of accuracy, as any senior citizen will tell you. This act is a government giveaway to the HMOs and the drug companies. My congressman sent me several pages from the *Congressional Record* of testimony by congressional representatives stating what was wrong with the law. Not only will the drug card not save much money but better, larger drug discounts are available from many sources, including neighborhood pharmacies. One of the biggest problems is the law states that the U.S. government cannot negotiate drug prices on behalf of Medicare. That is tantamount to telling the drug companies to "go ahead and raise prices some more." Just what seniors need.

–Morley G. Melden
Monroe Township, N.J.

DON'T BLOCK STEM-CELL RESEARCH

THE DEVELOPMENT OF stem-cell lines that can produce many tissues of the human body is an important scientific breakthrough, with the potential to revolutionize medicine and improve the quality and length of life ("The stem-cell flap: Simmer down," News: Analysis & Commentary, July 26). Anyone who has watched relatives, friends, or co-workers suffer with a neurological disease can attest to their devastation, the pain, and the anguish. Any relief is welcome and should be supplied. The hope that a patient could experience some respite or that a family might enjoy more time with the sufferer is an overwhelming prospect.

My mother passed away from Progressive Supranuclear Palsy (PSP), a Parkinson's-like disease, on Mar. 15, 2003. It was a long, torturous, and heroic fight. But in the end, PSP won. How I wish my moth could have suffered less and how I wis could have had more time with her. Ste cell research has the potential to gra those wishes to subsequent generation

–Diane E. Al
Long Branch, N

KEEPING CLEAN BOOKS ISN'T ROCKET SCIENCE

COMING FROM THE MEDICAL a pharmaceutical industries, I find t ideas in "The new accountabilit (News: Analysis & Commentary, July 2 to be too little, too late. For 35, maybe 4 years, the Food & Drug Administrati has held drug company presidents a CEOs personally and criminally liable the actions, inactions, and failures of th company's processes and products.

One can argue that, from the stan point of the shareholder, the "produ they are most concerned with is prope ly earned profit. These companies a among the most complex entities in t world to manage, not including the ob gations of sound financial managemen It should be far less difficult to monit

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CORRECTIONS & CLARIFICATIONS

n the Aug. 9 Readers Report, we nisspelled the name of letter-writer Marty eyer of Advanced Micro Devices Inc.

l be responsible just for "the num-'s," particularly when you are buying l selling a commodity, doing no R&D, l putting no one's health—other than ncial—at risk.

–John E. Marshall
Durango, Colo.

HERE EUROPEAN SOCCER TS AN EXTRA KICK

U'RE WRONG TO PAN the system of nual "relegation and promotion" be-een leagues of different standards Can soccer be saved?" International siness, July 19). That provides some of wildest and most exciting games to l each season. There's nothing com-able in American sports. The busi-s implications could easily be stabi-d if Europe changed to two up/two wn, or even one up/one down at the higher levels. To cushion the financial impact, the English Premier League gives a grant of around 10 million pounds to each relegated team. Wouldn't we all have fun watching the Yankees relegated to Triple-A ball? You also omit any mention of the most successful team in England for the past three or four years—and it's not Manchester United! With about 60% of Man U's revenue, Arsenal regularly tops them, primarily by having the best financial and field manager in Europe, Arsene Wenger.

–John Warren
Round Rock, Tex.

TAKING ON NEW YORK'S OTHER REAL ESTATE MOGUL

YOUR PROFILE OF Bruce C. Ratner of Forest City Ratner Cos. glosses over the public outcry about his proposed Brooklyn Atlantic Yards development: a project that includes 17 massive towers, in successful neighborhoods of low-rise, mixed-use buildings ("New York's other real estate mogul," People, July 19). The opposition is led by elected officials representing the area including the congressman, state senator, and me, a city council member. This could cost taxpayers $1.1 billion, according to a fiscal impact study, and does not provide for any governmental oversight.

–Letitia James
Council Member of the City of New York
Brooklyn, N.Y.

LOSING RESPECT FOR THE STREET'S 'BEST AND BRIGHTEST'

SO WALL STREET MALES still aren't passing the sex discrimination test ("A bad deal for women," Finance, July 26). If they were truly "the best and the brightest"—as they would have us believe—they would get rid of the unjust attitudes that make the rest of us lose respect for them. And to top it off, they think we should let them handle our money. Buyer beware.

–Grace Todd
Idaho Springs, Colo.

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Is America Going Broke?

RUNNING ON EMPTY How the Democratic and Republican Parties Are Bankrupting Our Future And What Americans Can Do About It
By Peter G. Peterson; Farrar, Straus and Giroux; 242pp; $24

THE COMING GENERATIONAL STORM What You Need to Know about America's Economic Future
By Laurence J. Kotlikoff and Scott Burns; MIT Press; 274pp; $27.95

According to the Congressional Budget Office, the budget deficit for fiscal year 2004 will be $422 billion, with the red ink over the next 10 years totaling in the trillions. Meanwhile, the Democrats and Republicans—and their associated economists—spar over who is to blame for the deficits, whether they are hurting the economy, and what can be done about them.

Against this political backdrop come two important but flawed books that focus on the long-term budget picture over the next 75 years. One is *Running on Empty* by Peter G. Peterson, an investment banker who is chairman of the Council on Foreign Relations. Then there's *The Coming Generational Storm* by Laurence J. Kotlikoff, a respected economist at Boston University, and Scott Burns, personal finance columnist for *The Dallas Morning News*. Both tell an exceedingly, perhaps excessively, gloomy story.

The two books make the same point: that an aging U.S. population, combined with out-of-control entitlement payments to the elderly, is leading to budget deficits of almost unimaginable size, imposing a heavy economic burden on future generations. Indeed, the authors use similar language. "There is no economic or demographic magic wand we can wave to make everything right," say Kotlikoff and Burns. "We are heading into one God-awful fiscal storm." Peterson, too, sees the coming decades as the "fiscal equivalent of a perfect storm."

Both books assemble projections that show Medicare and Social Security costs taking up a soaring share of national output for the coming 75 years. The result, they argue, will be either huge tax increases for the young, even more enormous government borrowing, or big cuts in benefits for the elderly.

None of these options is attractive, and all of them can potentially lead to disaster. For example, if the government tries to get out of trouble by borrowing more, or by printing more money, Kotlikoff and Burns note, investors "will quickly dump their holdings of U.S. Treasury and other bonds," leading to soaring interest rates and a falling dollar. This could subject the U.S. to the sort of financial crises seen in countries such as Argentina. In such a crisis, "a seemingly small factor can flip the switch on the economic electric chair," write the authors. "When that happens, the transformation from economic health to economic death is swift and merciless."

This pessimistic perspective, while a bit overwrought, ca certainly not be dismissed out of hand, either by policymakers or voters. Both books provide readable expositions of their arguments. The big difference is that Kotlikoff and Burns provide more specific policy suggestio than Peterson does—especially for reforming Medicare—as well as fairly good insights into how an individual can prepare financially for a world with a fiscal catastrophe. Peterson, by contrast, is more concerned with the moral failings of America's economic policy, ladling equ blame on both Republicans and Democrats: "Both political parties have formed an unholy alliance—an undeclared war on the future." he writes. "An undeclared war, that is, on our children."

Yet the authors of both books can be taken to task for the same failing: They are obsessed with demographic changes and the growing gap between government spending and revenues, but they utterly dismiss the effects of growth. Thus, in the words of Kotlikoff and Burns, "economic growth is not going to bail us out." And Peterson calls one section of his book "The 'Grow the Economy' Fantasy."

Moreover, both books express extreme distrust of technology and warn the reader not to count on it to solve our problems. "The lesson here is that we can't be sure about technology and future economic growth," write Kotlikoff and Burns, who then go on to suggest that the 1990s boom was overstated. Adds Peterson: "This is no the first time self-appointed prophets have proclaimed the arrival of a new era of endless prosperity, only t be proved laughably wrong."

Yet in reality, the rate of productivity growth over the next century will be the key factor determining whether adjusting to an aging population is easy or difficult. Consider the "dependency ratio"—the ratio of Americans 65 and older to those 20 to 64. The number of elderly for each working-age person more than doubles from 2005 to 2080, according to Social Security Administration (SSA) projections cited by Kotlikoff and Burns. That sounds mighty scary.

In fact, the change in demographics is a slow-moving process that can easily be overcome by decent productivity gains. Since the mid-1990s, productivity growth for the whol economy has averaged 2.3% or so, according to the SSA. If

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t performance is continued into the ıre, then output per person goes up times over the next 75 years. With litional improvement, to 3% annual ductivity growth, each working son will be able to produce nine es more than today. (By comparison, ts own forecasts the SSA assumes rage productivity gains of only 1.6% year). Thus it becomes a lot easier to how we could have sufficient ources for an aging population.

Ah, but the authors of both books e already provided an answer to that. ey argue that faster productivity wth would just lead to higher nding on retirement and medical nefits. "A robust economy," writes erson, "would by itself cause Social urity benefits, which are l to wages, to become re generous, while also ther inflating health care ts." Kotlikoff and Burns nforce this point by ng approvingly from a 03 study that estimated e long-term fiscal ›"—the present value of difference between the ernment's future enditures and future eipts. The resulting mber, $45 trillion in today's dollars, s astronomical enough. But the study o reported that higher productivity wth would lead to a bigger fiscal gap, a smaller one, as benefits rose faster n revenues.

However, Peterson, Kotlikoff, and rns miss a crucial factor: A fast-wth economy makes it much easier ind a politically and economically atable solution to the fiscal-gap blem. Consider that under current jections, Medicare is expected to rise almost 14% of gross domestic product er that span, up from 2.6% in 2003. at's based on the SSA's relatively ssimistic forecasts for future ductivity and GDP growth.

Now let's assume instead that the S. has a fast-growth economy that n expand at 3% a year for the next 75 ars—with the extra growth coming m new technologies, perhaps. It ns out that in 2080, just 7% of the t-growth economy would provide as ch real resources for Medicare as % of the slow-growth economy. Thus, a fast-growth economy we could put ap on Medicare expenditures as a are of GDP and still spend as much health care, in real terms, as in today's slow-growth projections.

Still, even if growth can lift some of the long-term gloom from the forecasts, the fiscal structure of both Medicare and Social Security still has to be revamped to be able to take advantage of the growth. Peterson favors a fairly conventional list of fixes: He would cut "the abundance of fraud and waste" in Medicare, promote public health, and "face hard choices," by putting caps on spending.

By contrast, the policy solutions of Kotlikoff and Burns are specific and ingenious. For example, they would freeze benefits from Social Security at their current levels and fund them with a federal retail sales tax. Kotlikoff and Burns argue that would be a much broader and less regressive tax than the current payroll tax, which is not applied to incomes over a certain amount ($87,900 in 2004). At the same time, workers would make compulsory contributions to a "Personal Security System" that invests in a single market-weighted global index fund of stocks, bonds, and real estate. When people retire, they would get an inflation-protected pension, based on the value of their investments—and with the real principal of their contributions guaranteed.

These two jeremiads overstate the case for fiscal meltdown

Moreover, one of the real strengths of the Kotlikoff and Burns book is that it gives some fairly good insights about how individuals can prepare themselves for a future economy in which tax rates and inflation rise and social benefits become smaller. They warn against depending too heavily on 401(k)s, noting that "even a modest inflation rate may negate the benefit of 401(k) and IRA saving for many workers." Instead, they lay out a portfolio for savings, including mutual funds that specialize in gold and other precious metals, energy mutual funds, inflation-protected bonds, and international equity funds, especially those focused on China.

Peterson, Kotlikoff, and Burns are far too gloomy about the future prospects of the baby-boomer generation and its children. Nevertheless, the real import of their argument is that even with growth, the financing of the current entitlement system will eventually have to be dramatically rebuilt—and that's a message that should be heard. ■

–By Michael J. Mandel

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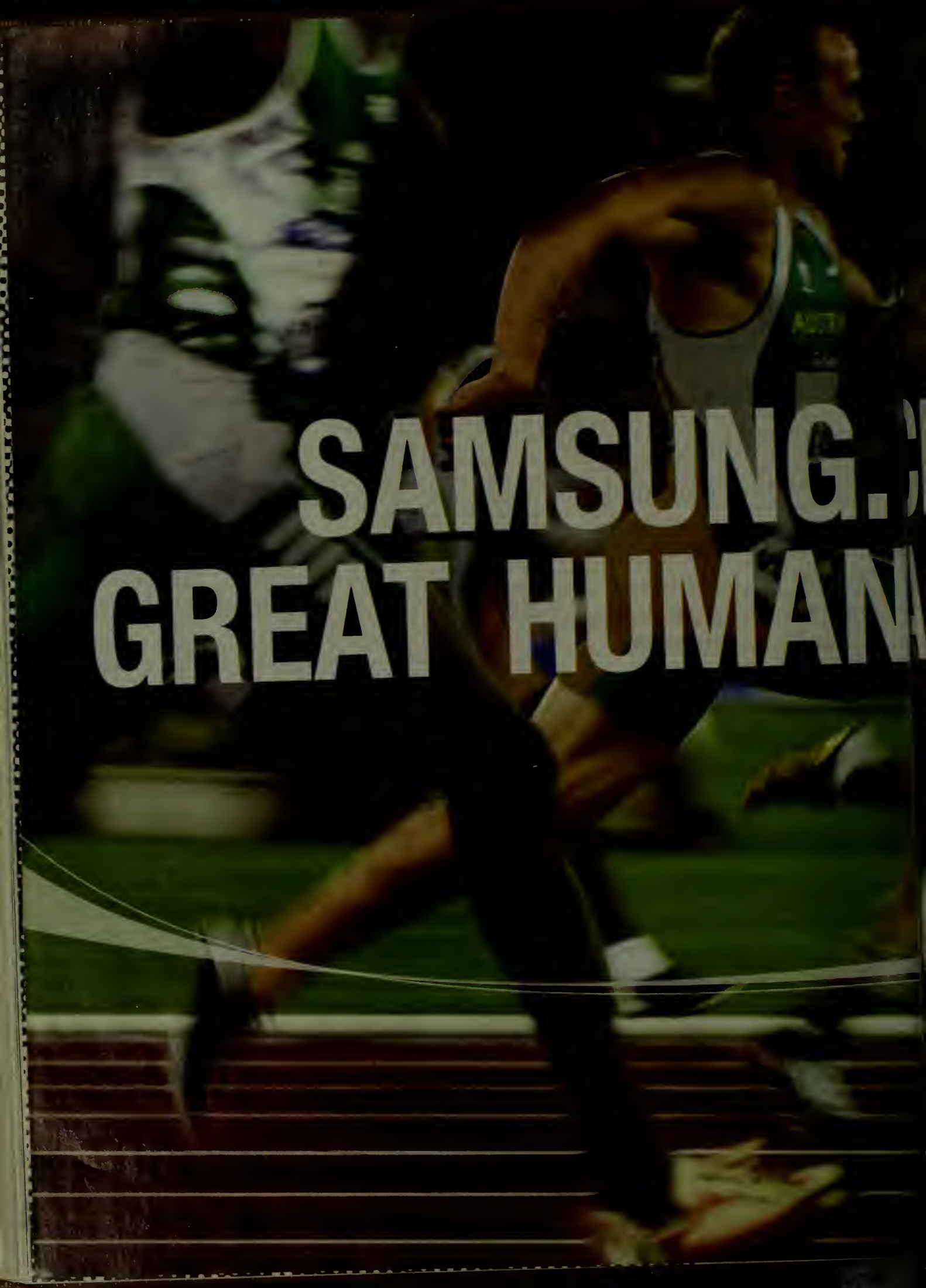
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BY ROBERT J. BARRO

Drugs Via Canada? The Side Effects Could Hurt

A major challenge for health-care policy is the high price of prescription drugs. In his speech at the Democratic Convention, Senator John Kerry endorsed proposals to cut prices by facilitating reimportation of cheaper drugs from Canada. The rationale is to spur competition. Companies would be forced to compete with themselves. For example, Pfizer Inc.'s direct sales of Viagra to the U.S. market would compete with its indirect sales, which go to Canada and would then return to the U.S.

The key feature of the pharmaceutical business is the up-front outlay for drug discovery. Drugmakers spend billions to develop new treatments and prove their efficacy and safety to the Food & Drug Administration. Much of this research-and-development expenditure goes into drugs that fail. However, once a company succeeds, the costs of production and distribution are small. Making and selling a million Viagra tablets costs little compared with the earlier R&D spending.

In order for the pharmaceutical market to function efficiently, companies must have incentives to invent new drugs. One possibility: The government could pay large prizes for successful drugs. Unfortunately, figuring out how much to award and for what is technically difficult and politically unlikely. Therefore, the incentive has to come from profits for selling successful drugs at high prices—higher than the costs of producing already invented drugs.

THE INCENTIVE TO INVENT NEW DRUGS depends on worldwide profits. Some profits come from the U.S. market and some from abroad. U.S. consumers may not like paying the high prices that generate such profits. But everyone in the U.S. should be happy about foreigners paying high prices. Profits generated overseas raise the incentive to invent new drugs without requiring even higher U.S. drug prices.

So how does Canada fit in? If customers could be separated into distinct markets, drug companies would price at different levels in different places. For example, companies would charge relatively low prices in poor countries because sales at U.S. prices would be close to zero. For well-off Canada, profit-maximizing prices theoretically should be similar to those in the U.S. However, Canada's regulatory agency and the provincial health insurers have managed to hold down drug prices because they set price ceilings, buy in bulk, and negotiate directly with drug companies.

Canadians gain advantage from their regulations because they get existing drugs at lower prices and still benefit from new U.S. drug development. Potential profits from Canadian sales of drugs are a small part of worldwide U.S. drug company earnings, so the adverse effects on incentives are minor. Canada, however, is effectively free-riding (or rather, half-riding) on the U.S. by not paying its "fair share" of the profit incentives for drug discoveries.

What works for Canada would work for a single U.S. state, ideally a small one, such as Vermont, which already encourages reimportation from Canada. But this policy is a burden on the other 49 states. Think what would happen if residents of all 50 states got drugs at Canadian prices. Profits would fall, hampering the development of new drugs.

If Americans really want lower prices, there are ways to accomplish this without incurring the costs of moving drugs to and from Canada. The U.S. could shorten the period of patent protection from 17 years to 10, make it easier for generics to challenge existing patents (as Congress did to some extent in the 1980s), or regulate prices of patented drugs. Pursuing these policies would be a mistake because the current setup strikes a reasonable balance between incentives for invention and the prices of existing drugs. But at least these proposals would be intellectually more respectable than reimporting drugs.

> Those high prices for winners provide the incentive for R&D

Another point is that drug companies sell at 50% off in Canada only because they can reasonably well isolate the Canadian market from the U.S. one. Policies that facilitate reimportation of drugs make it harder to separate those markets. If the leakage to the U.S. became large, as it would if reimportation were fully legal and convenient, drug companies would be unwilling to sell in Canada at 50% off. The companies would insist on 100% prices or else would not sell there. Thus, Canada has the greatest self-interest in preventing massive reimportation of drugs to the U.S. ■

Robert J. Barro *is a professor of economics at Harvard University and a senior fellow of the Hoover Institution (rjbweek@harvard.edu)*

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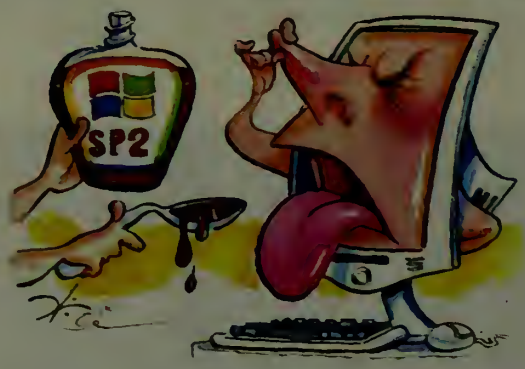
BY STEPHEN H. WILDSTROM

Windows: Security Is Suddenly Job One

Microsoft has always promoted new versions of Windows by talking up features designed to make computer use easier and more fun. The prosaically named Windows XP Service Pack 2 is starkly different. While it amounts to a major release in size and scope, it could also be called the cod liver oil of software upgrades: nasty but good for you.

SP2, which was published on Aug. 6 and will be available through the Windows Update service by the end of the month, is an outgrowth of Microsoft's two-year-old initiative to fix Windows' pervasive security problems. It marks a reversal of Microsoft philosophy that routinely favored convenience over security.



Internet Explorer is Exhibit A. It was designed to make it easy for Web sites to download software—from browser plug-ins to entire applications—to PCs, with little or no intervention from the user. This process has proved to be hopelessly insecure, contributing to an epidemic of viruses, worms, Trojan horses, and other plagues.

IE gets a total rewrite in SP2, designed to make it harder but safer to use. The biggest changes in the browser, not available for Windows versions other than XP, affect the handling of downloads. You must explicitly approve the download of any files other than pictures or sounds that are part of the page, and give further permission to install programs. Moreover, IE objects if the Web site cannot certify the software's publisher. (For more on this technology and how it can protect you, see businessweek.com/technology.)

I SPENT SEVERAL WEEKS RUNNING preliminary versions of SP2. For most Web sites, it works fine, though downloads can be a bit of a nuisance. On sites that I have known to be sources of surreptitious spyware, the browser froze instead of notifying me that a download had been blocked. Rebooting was annoying but better than the alternative. Some public Web sites and many corporate custom applications will have to be reprogrammed to work with the new version.

Another obvious change in SP2 is the new Windows Firewall. The system, designed to block worms from attacking your computer over a network, is much more capable than the older Internet Connection Firewall. Unlike its predecessor, it is automatically turned on—and Windows objects if you turn it off. When a program not on the firewall's approved list (which includes key Microsoft applications such as Internet Explorer, Outlook, and Outlook Express) tries to gain access to a network, the firewall will block it until you grant permission. This may stop spyware and other nasty programs th have sneaked onto your computer fro reporting back to their servers. The firewall is not as comprehensive or configurable as third-party offerings such as Symantec's Norton Personal Firewall, McAfee Personal Firewall, o Zone Lab's Zone Alarm. But it's a big step toward safer computing.

This upgrade should zap more viruses, worms, and other nasties

The new Windows Security Center is also a step up. It repor the status of your firewall (recognizing third-party produc as acceptable alternatives to the Windows Firewall), checks you antivirus software, and nags yo to enable automatic downloadi of security patches from Windows Update.

SP2 will be a challenging download, since it runs about 80 megabytes. It will be distributed through Windows Update beginning in late August, but anyone who uses dial-up will probably want to order the free CD from Microsoft. And it's a good idea to bac up your PC before installing it. My upgrade on several computers went flawlessly, but one failed, leaving a laptop unable to boot.

The new software doesn't offer any of the usual incentives to upgrade—new features or better performance. But by attacking some of the worst security problems in Windows, i could save you a lot of trouble. Bite the bullet and install it, the sooner the better. ■

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WHAT IS LEVITRA?

LEVITRA is a prescription medicine taken by mouth for the treatment of erectile dysfunction (ED) in men.

ED is a condition where the penis does not harden and expand when a man is sexually excited, or when he cannot keep an erection. A man who has trouble getting or keeping an erection should see his doctor for help if the condition bothers him. LEVITRA may help a man with ED get and keep an erection when he is sexually excited.

LEVITRA does not:

- cure ED
- increase a man's sexual desire
- protect a man or his partner from sexually transmitted diseases, including HIV. Speak to your doctor about ways to guard against sexually transmitted diseases.
- serve as a male form of birth control

LEVITRA is only for men with ED. LEVITRA is not for women or children. LEVITRA must be used only under a doctor's care.

HOW DOES LEVITRA WORK?

When a man is sexually stimulated, his body's normal physical response is to increase blood flow to his penis. This results in an erection. LEVITRA helps increase blood flow to the penis and may help men with ED get and keep an erection satisfactory for sexual activity. Once a man has completed sexual activity, blood flow to his penis decreases, and his erection goes away.

WHO CAN TAKE LEVITRA?

Talk to your doctor to decide if LEVITRA is right for you.

LEVITRA has been shown to be effective in men over the age of 18 years who have erectile dysfunction, including men with diabetes or who have undergone prostatectomy.

WHO SHOULD NOT TAKE LEVITRA?

Do not take LEVITRA if you:

- **take any medicines called "nitrates"** (See "What important information should you know about LEVITRA?"). Nitrates are commonly used to treat angina. Angina is a symptom of heart disease and can cause pain in your chest, jaw, or down your arm.

  Medicines called nitrates include nitroglycerin that is found in tablets, sprays, ointments, pastes, or patches. Nitrates can also be found in other medicines such as isosorbide dinitrate or isosorbide mononitrate. Some recreational drugs called "poppers" also contain nitrates, such as amyl nitrate and butyl nitrate. Do not use LEVITRA if you are using these drugs. Ask your doctor or pharmacist if you are not sure if any of your medicines are nitrates.
- **take medicines called "alpha-blockers."** Alpha-blockers are sometimes prescribed for prostate problems or high blood pressure. If LEVITRA is taken with alpha-blockers, your blood pressure could suddenly drop to an unsafe level. You could get dizzy and faint.
- **you have been told by your healthcare provider to not have sexual activity because of health problems.** Sexual activity can put an extra strain on your heart, especially if your heart is already weak from a heart attack or heart disease.
- **are allergic to LEVITRA or any of its ingredients.** The active ingredient in LEVITRA is called vardenafil. See the end of this leaflet for a complete list of ingredients.

WHAT SHOULD YOU DISCUSS WITH YOUR DOCTOR BEFORE TAKING LEVITRA?

Before taking LEVITRA, tell your doctor about all your medical problems, including if you:

- **have heart problems** such as angina, heart failure, irregular heartbeats, or have had a heart attack. Ask your doctor if it is safe for you to have sexual activity.
- **have low blood pressure** or have high blood pressure that is not controlled
- **have had a stroke**
- **or any family members have a rare heart condition known as prolongation of the QT interval (long QT syndrome)**
- **have liver problems**
- **have kidney problems and require dialysis**
- **have retinitis pigmentosa**, a rare genetic (runs in families) eye disease
- **have stomach ulcers**
- **have a bleeding problem**
- **have a deformed penis shape** or Peyronie's disease
- **have had an erection that lasted more than 4 hours**
- **have blood cell problems** such as sickle cell anemia, multiple myeloma, or leukemia

CAN OTHER MEDICATIONS AFFECT LEVITRA?

Tell your doctor about all the medicines you take including prescription and non-prescription medicines, vitamins, and herbal supplements. LEVITRA and other medicines may affect each other. Always check with your doctor before starting or stopping any medicines. Especially tell your doctor if you take any of the following:

- medicines called nitrates (See "What important information should you know about LEVITRA?")
- medicines called alpha-blockers. These include Hytrin® (terazosin HCl), Flomax® (tamsulosin HCl), Cardura® (doxazosin mesylate), Minipress® (prazosin HCl) or Uroxatral® (alfuzosin HCl).
- medicines that treat abnormal heartbeat. These include quinidine, procainamide, amiodarone and sotalol.
- ritonavir (Norvir®) or indinavir sulfate (Crixivan®)
- ketoconazole or itraconazole (such as Nizoral® or Sporanox®)
- erythromycin
- other medicines or treatments for ED

HOW SHOULD YOU TAKE LEVITRA?

Take LEVITRA exactly as your doctor prescribes. LEVITRA comes in different doses (2.5 mg, 5 mg, 10 mg, and 20 mg). For most men, the recommended starting dose is 10 mg. **Take LEVITRA no more than once a day.** Doses should be taken at least 24 hours apart. Some men can only take a low dose of LEVITRA because of medical conditions or medicines they take. Your doctor will prescribe the dose that is right for you.

- If you are older than 65 or have liver problems, your doctor may start you on a lower dose of LEVITRA.
- If you are taking certain other medicines your doctor may prescribe a lower starting dose and limit you to one dose of LEVITRA in a 72-hour (3 days) period.

Take 1 LEVITRA tablet about 1 hour (60 minutes) before sexual activity. Some form of sexual stimulation is needed for an erection to happen with LEVITRA. LEVITRA may be taken with or without meals.

Do not change your dose of LEVITRA without talking to your doctor. Your doctor may lower your dose or raise your dose, depending on how your body reacts to LEVITRA.

If you take too much LEVITRA, call your doctor or emergency room right away.

WHAT ARE THE POSSIBLE SIDE EFFECTS OF LEVITRA?

The most common side effects with LEVITRA are headache, flushing, stuffy or runny nose, indigestion, upset stomach, or dizziness. These side effects usually go away after a few hours. Call your doctor if you get a side effect that bothers you or one that will not go away.

LEVITRA may uncommonly cause:

- **an erection that won't go away (priapism).** If you get an erection that lasts more than 4 hours, get medical help right away. Priapism must be treated as soon as possible or lasting damage can happen to your penis including the inability to have erections.
- **vision changes,** such as seeing a blue tinge to objects or having difficulty telling the difference between the colors blue and green.

These are not all the side effects of LEVITRA. For more information, ask your doctor or pharmacist.

HOW SHOULD LEVITRA BE STORED?

- Store LEVITRA at room temperature between 59° and 86° F (15° to 30° C).
- **Keep LEVITRA and all medicines out of the reach of children.**

GENERAL INFORMATION ABOUT LEVITRA.

Medicines are sometimes prescribed for conditions other than those described in patient information leaflets. Do not use LEVITRA for a condition for which it was not prescribed. Do not give LEVITRA to other people, even if they have the same symptoms that you have. It may harm them.

This leaflet summarizes the most important information about LEVITRA. If you would like more information, talk with your healthcare provider. You can ask your doctor or pharmacist for information about LEVITRA that is written for health professionals.

For more information you can also visit www.LEVITRA.com, or call 1-866-LEVITRA.

WHAT ARE THE INGREDIENTS OF LEVITRA?

Active Ingredient: vardenafil hydrochloride

Inactive Ingredients: microcrystalline cellulose, crospovidone, colloidal silicon dioxide, magnesium stearate, hypromellose, polyethylene glycol, titanium dioxide, yellow ferric oxide, and red ferric oxide.

Norvir (ritonavir) is a trademark of Abbott Laboratories
Crixivan (indinavir sulfate) is a trademark of Merck & Co., Inc.
Nizoral (ketoconazole) is a trademark of Johnson & Johnson
Sporanox (itraconazole) is a trademark of Johnson & Johnson
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Flomax (tamsulosin HCl) is a trademark of Yamanouchi Pharmaceutical Co., Ltd.
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/ JAMES C. COOPER & KATHLEEN MADIGAN

Those Soft Job Numbers: Cause for Alarm?

robably not—business is still spending, and not all the data are so gloomy

U.S. ECONOMY The release of the July employment numbers was éjà vu all over again. Just as with the disappointing June jobs data, ıe Aug. 6 report, which showed only 32,000 jobs created in July, aused investors, economists, and policymakers to do a double take. he July report was expected to show a jump of 250,000. Some alysts predicted a surge above 300,000. A hefty payroll in would support the idea that the economy is aining speed after a spring slowdown. It would also ıew optimism on Wall Street and justify continued erest-rate hikes by the Federal Reserve.

Instead, economists are marking down their second-lf forecasts. Investors are wary about the profits tlook. The Dow Jones industrial average fell a steep 148 ints after the release of the jobs report and remains low 10,000.

For its part, the Fed seemed to downplay the jobs data. expected, the Fed lifted the federal funds rate by a arter-point, to 1.5%, at its Aug. 10 policy meeting. The companying statement acknowledged that output and provements in the labor markets have slowed. But it t the blame largely on higher energy prices. As long as 's upward push on inflation is transitory, the Fed said e economy "appears poised to resume a stronger pace expansion going forward."

Policymakers reiterated that they could continue to move policy accommodation at a "measured" pace. But st as in its June 30 statement, the Fed warned it would spond "to changes in economic prospects as needed to lfill its obligation to maintain price stability."

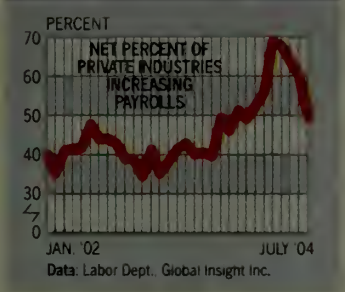
Analysts interpreted the statement to mean the Fed ll move the funds rate up another quarter-point at its pt. 21 meeting. Odds for that move will lessen, wever, if the August employment report proves as sappointing as July's.

JT SHOULD THE WEAK JOBS REPORT have been ch a shock? After all, the economy slowed in the second arter, growing at just a 3% annual rate. That low rate ggested companies may have gotten ahead of emselves when they went on a hiring spree from March rough May. In addition, continued turmoil in Iraq, the ggish stock market, and uncertainty about the esidential election seem to have caused a run of rporate paralysis. In addition, questions about the ture of oil prices and supplies are also weighing on the tlook (page 44).

Bear in mind that corporate caution held back the covery in 2002 and early 2003. Buffeted by accounting scandals and war talk, executives at that time delayed investing in new equipment or adding workers and let inventories shrink dramatically.

That probably won't happen again. First, businesses are optimistic about the second half. Second, the revised GDP data show business-equipment spending has risen for five quarters in a row. And in the first half, inventories grew at the fastest two-quarter pace since 2000.

FEWER COMPANIES ADDED JOBS IN JULY



Data: Labor Dept., Global Insight Inc.

But once again, companies have reacted to a mild—and, in the Fed's view, probably short-lived—slowing in demand by curtailing hiring. Although still small, the risk to the outlook is that corporate inaction could drag down total demand, especially if another oil-related shock occurs. If so, personal incomes won't rise fast enough to offset higher fuel prices. That will force consumers to cut back on other purchases. Pay is already being squeezed: In July, hourly pay rose 1.9% from a year ago, below the latest yearly inflation of 3.3%. Renewed job jitters might also slow second-half buying plans.

CORPORATIONS' LATEST RELUCTANCE to hire can be seen in the Labor Dept.'s employment data. Job gains in June and July slowed to a 55,000 average monthly pace, a steep drop from the 225,000 average in the first five months. Moreover, the breadth of hiring has narrowed. In March, 68.7% of private industries added workers. By July the rate was less than 50% (chart). The average workweek, at 33.7 hours, was shorter than its May length of 33.8 hours.

Job losses were greatest in areas where demand has weakened. For example, retailing, where spring sales were soft, cut 19,100 jobs in July. Meanwhile, mortgage refinancing activity is down and credit intermediation positions, which include mortgage brokers, fell by 15,800.

However, some bright spots were evident in the jobs

report. The unemployment rate slipped to 5.5% from 5.6%. Manufacturing added 10,000 new jobs; the gain would have been much higher if not for losses in the transportation-equipment sector. Presumably that reflects temporary layoffs as auto makers closed down for annual model changeovers. If so, transportation equipment should show a healthy rebound in August.

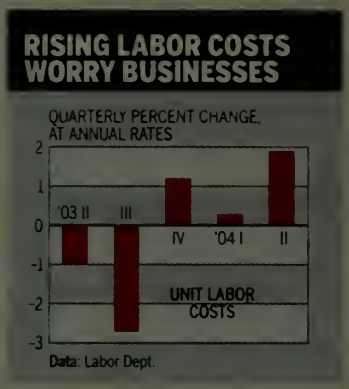
In addition, health care continued to add workers. Professional service jobs rose by a large 42,000, and restaurants and bars added 7,800 to their staffs.

SO FAR IN 2004, nonfarm job growth has averaged a healthy 176,000 per month. Against that trend, the July job gain would normally not be cause for alarm. But this is not a normal year. In the current Presidential campaign, the economy in general—and job growth in particular—is a major issue. Each side will dissect the data to prove its point right up until Nov. 2.

What the campaigns largely ignore is that the labor markets have evolved as U.S. businesses have had to adapt to a more global, more competitive economic environment over the past decade. Cost-cutting remains uppermost in most executives' minds. That's why businesses still look to productivity rather than to labor for increased output. Output per hour worked in the nonfarm business sector grew at an annual rate of 2.9% in the second quarter, accounting for nearly all of the growth in output.

But the productivity gain wasn't enough to offset the 4.9% rise in compensation. That meant unit labor costs rose 1.9%, the fastest increase in two years (chart). Renewed cost pressures fly in the face of Corporate America's attempt to compete against global rivals whil also keeping stock prices rising. No wonder companies tried not to hire much in July.

To a large extent, it's not wage pressures causing the reluctance to hire: Gain in hourly wages and salaries have slowed significantly over the pa four years. Benefits are the problem. Their cost jumped by 7.3% in the year ended in the secon quarter, the largest increase in two decades



The money companie are saving on payrolls will go toward equipme that will keep productivity rising. That increased spending is why the economy should keep posting good growth in the secon half even if payroll gains may not be as impressive. And the productivity increases reaped from the machinery should reduce the pressures on profit margins coming from higher energy and labor costs.

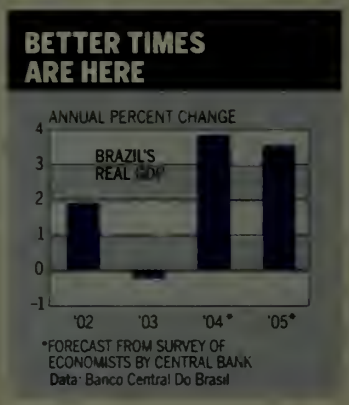
The upshot is that labor markets are now as flexible a an Olympic gymnast—and businesses want them to stay that way. Any President will find it extremely difficult to change that situation. ■

BRAZIL

Lula's Unlucky Streak Is Lifting

THE TIDE may finally be turning for Brazilian President Luiz Inácio Lula da Silva. After a year and a half of rising unemployment, falling consumption, and increasingly unhappy voters, Lula is finally presiding over an economy that is on the path to a sustained recovery.

The country began to turn around in the middle of last year, but voters were fixated on the 0.2% contraction for all of 2003—far short of the "spectacle of growth" that Lula promised during his 2002 campaign. In the first quarter of 2004, real gross domestic product rose at a quarterly rate of 1.6%. That has the economy well on its way to beat the government target of 3.5% growth for all of 2004 (chart). Exports are booming due to a weaker currency, high prices for commodities such as soybeans and steel, and productivity gains.



The key to faster growth will be domestic demand. Consumers are finally spending now that the labor and financial markets are improving. The jobless rate, which peaked at 13.1% in April, fell to 11.7% in June. Wages are also picking up, with a jump of 1.8% in June. And although the central bank's base interest rate stands at a lofty 16%, it has fallen a long way from 26.5% at the start of 2003. What's more, the interest spreads—the difference between borrowing and saving rates—are also easing. As a result, sales of big-ticket items, among the first sectors benefit from lower rates, are rising, with food and clothing sales in tow.

Voters are finally noticing. A national opinion poll published on Aug. 10 showed the government's approval rating bounced up a health 9 percentage points, from 29% in June to 38% in August. That was its first gain after a string of declines. Lula's personal rating also improvec from a low point of 54%, to 58%.

Even so, Lula is not out of the woods. Accusations of tax evasion caused the resignation of a senior central bank official last month. The presidents of the central bank and th public sector Banco do Brasil face similar allegations. The opposition will exploit the government's problems in the runup to important municipal elections in October. The good news for Lula is that what real matters to voters is the economy. ■

–By Jonathan Wheatley in São Pau

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THE ECONOMY

COPING WITH SKY-HIGH OIL PRICES

Why are they surging—and how will the economy fare? It's likely inflation will stay cool, but so will hiring

THE SIGNS ARE ALL THERE for a perfect storm. Global demand for oil is surging, supplies are tight, and geopolitical jitters are sending almost daily shock waves through the markets. As a result, oil prices have hit record highs. Economic growth and hiring already have shown signs of slowing in the U.S. And economists are increasingly concerned that both the global and U.S. recoveries could suffer a setback if prices remain at the $45 per barrel level—or spike even higher because of a major terrorist attack or other cataclysmic event.

Here is a look at the powerful forces at play in the oil markets and the global economy:

What's behind today's high oil prices?
It starts with an unexpected hike in demand. Rapidly rising oil consumption has eaten away the margin of safety provided by the ample spare production capacity recently provided by OPEC. With little surplus capacity available, buyers are worried that potential disruptions in a number of producing countries including Russia, Iraq, Saudi Arabia, and Venezuela could lead to major shortages and further spikes in prices. In 2001, OPEC had almost 6 million barrels per day in extra capacity it could call on. Now it is pumping close to flat-out.

Not only are prices high, but day-to-day swings of $1 or more a barrel are increasingly common as traders react to such news as the temporary Aug. 9 shutdown of production in Iraq. "The impact of any event is greatly magnified," say Paul Horsnell, head of energy research Barclays Capital in London.

Why has huge demand caught the world by surprise?
A synchronized global recovery is the ke factor. For perhaps the first time, most the planet is growing in tandem. De mand, according to the International En ergy Agency, is likely to grow by a recor 2.5 million barrels per day in 2004, 3.2% increase from last year. Consump tion growth in 2004 alone is likely to b close to the total reached between 199 and 2002, even though many had bee predicting relatively stagnant demand.

The hottest growth area has been Chin which clocked sizzling year-on-ye increases of more than 20% in April an

SO IN THIS SECTION:

9 Are speculators driving up oil prices?

50 Detroit needs to hustle to make SUVs safe

52 Boston Scientific's recalls rattle investors

54 Shedding some light on Google's IPO

May. This year China will suck up 830,000 barrels a day more oil than last year, the IEA estimates, accounting for a third of world demand growth. As their incomes boom, the Chinese are buying cars even as the government rushes to build more roads to accommodate all the new traffic. Switching manufacturing from the West and Japan to less efficient facilities in China just adds to the nation's thirst for oil.

The U.S., too, continues to defy predictions as the economic recovery chugs along and as Americans continue to buy gas-guzzling vehicles and energy-gobbling McMansions. In the second quarter, America's demand for oil grew by 3.5%, the biggest gain since 1999.

Why hasn't production capacity kept pace with demand?

Both the oil majors and the national oil companies that dominate OPEC production have underinvested in bringing new supplies to market. OPEC's foot-dragging developing the 76% of world oil reserves under its sands and swamps is the biggest problem. Incredible as it may seem, OPEC's production capacity has actually declined over the last quarter-century from about 34 million barrels per day in 1979 to about 30 million barrels now. With OPEC imposing production cuts on its members to prop up prices, governments have seen little point investing in new output. Political turmoil, wars, and nationalizations have led to production declines in major producers including Iraq, Iran, and Libya. And most Middle East producers have also severely limited oil companies' access to their reserves

In many respects, today's supply constraints stem from the late 1990s, when OPEC overproduction undermined the market. With prices approaching $10 per barrel back then, the oil majors became ultraconservative—and they remain so today because they fear OPEC will once again pull the rug out from under them. As a result, they won't touch projects unless they promise at least 15% returns. What's more, pressure from profit-hungry investors has prompted the majors to chop exploration budgets and avoid taking big risks.

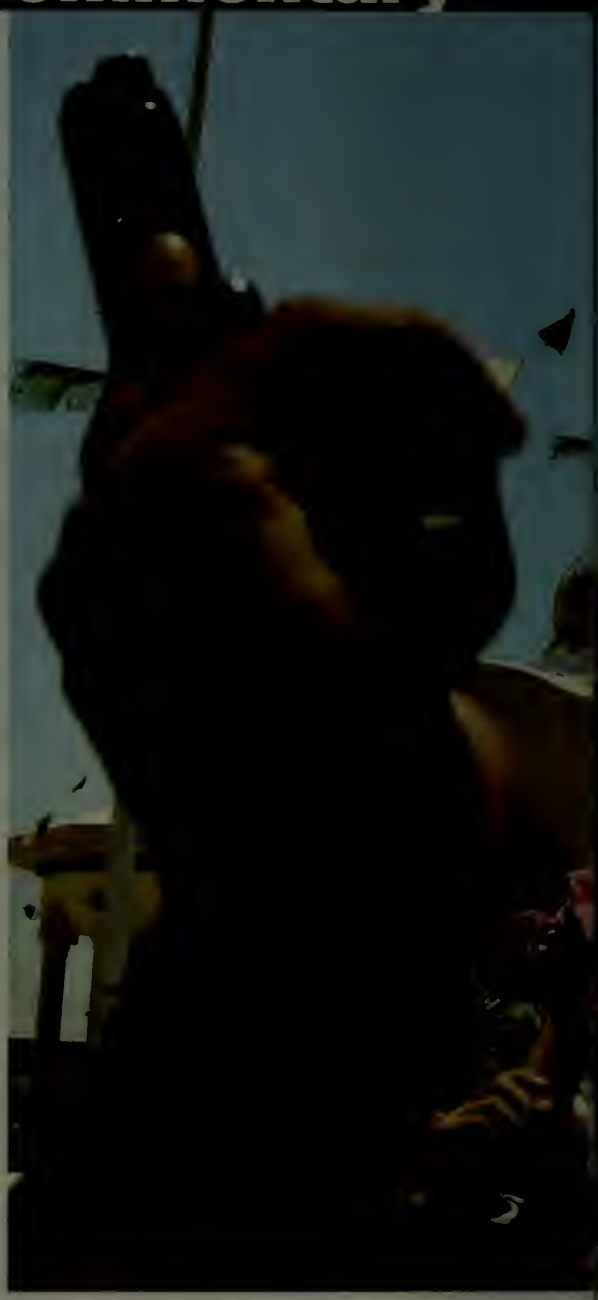
TRIGGER-HAPPY IN BASRA
Markets are edgy about such uncertainty as Iraqi unrest

Has the oil merger boom of the late 1990s discouraged investment?

The jury is still out, but some analysts believe it may be having an impact. Since the consolidation, says Richard Gordon, executive vice-president at Norwalk (Conn.)-based oil consultants John S. Herold Inc., companies have tended to ax "aggressive new venture programs" in favor of concentrating capital on existing discoveries that were ready to develop. One result: There isn't a huge pool of newly discovered reserves for the companies to develop now.

Has American policy exacerbated the oil squeeze?

Yes. The Bush Administration has done little to encourage conservation. One glaring example: There's been scant pressure on auto makers to improve gas mileage, making supply shocks more probable. U.S. policy in the Middle East, moreover, has had unintended consequences. Economic sanctions against Iran, Iraq, and, until recently, Libya, may be justified. But they hurt the oil industries of these countries, probably reducing supplies. While the war in Iraq was intended to help stabilize the region over the long run, so far it has unleashed anarchy in the country that has the world's second-largest oil reserves. Iraqi production has yet to consistently recover to prewar levels.



Will geopolitical jitters continue?

Most likely. For starters, there isn't ar quick resolution in sight to the strugg over Yukos, the Russian oil company th exports a hefty 1.3 million barrels per da Christopher Weafer, chief strategist Alfa Bank in Moscow, doubts that Pres dent Vladimir V. Putin would sev Yukos' exports for a lengthy period, sin it would damage the international stan ing of his government and wipe out a m jor source of foreign exchange. But the are no guarantees that such worries w deter Putin's henchmen, who seem dete mined to bring the nation's most impo tant industry back under greater sta control. Disruption or not, the whole a fair is bound to discourage and delay i vestment in the Russian oil industr which has accounted for nearly all of no OPEC production growth in recent year

Iraq, obviously, is also a mess. Insu

The biggest problem is OPEC's reluctance to develop its vast oil reserves: In the last quarter-century, its capacity has fallen from 34 million barrels per day in 1979 to 30 million

ıts have demonstrated that they are ›able of shutting down the country's ›orts for days at a time. There are two ›er linings: The Iraqis are fairly adept ›atching up pipelines after the insur- ıts blow them up. They also have a ›gh new leader in Prime Minister Ayad ›awi, a former Baathist who is trying to ›h co-opt and smash his opponents. ›l, Iraq is likely to roil the markets for ›ne months to come.

Huge outages in other producing re- ›ns seem less likely. While the continu- Islamist violence in Saudi Arabia is ›ifying, especially to expatriates, it has to threaten oil supplies. Venezuela re- ›ins a wild card with simmering oppo- ›on to President Hugo Chávez always ›eatening to boil over.

›ere do prices go from here?

›day's inventory levels, which are slightly below the five-year average, would, in a calmer international environment, be expected to produce prices in the low $30s per barrel. But as long as the international situation remains tense, prices will remain higher. Says Edward L. Morse, senior adviser at trading firm HETCO in New York: "Fifty dollars looks much more likely than $30, and even $100 cannot be ruled out."

Still, many analysts think it will take a major event to push prices up much higher than they are now. What's encouraging is that the markets are coping quite well. There have been no major shortages and buyers are able to secure plenty of oil—albeit at a price. The situation could even ease somewhat in the coming months as Saudi Arabia, Iran, and Algeria add another 1 million barrels a day or more to capacity. That probably means that unless something happens to considerably worsen the supply situation, prices could peak at the mid-$40s. "The only thing that's going to drive prices much higher is some big disruption," says Michael Smith, the head of energy analysis at BP PLC in London. Of course, it wasn't that long ago that analysts thought oil prices in the $30s couldn't last.

Do high oil prices have the same impact on the economy as in the past?

The answer seems to be yes—and no. High oil prices still act like a tax that hits consumers and businesses on a material and psychological level. But the recent spike will not ignite inflation this time round. Indeed, with the job market weak, workers aren't able to negotiate wage increases that in the past have fueled rising prices. Costlier oil instead is having a cooling impact on hiring. That's partly because worries about further price spikes, as well as terrorism jitters, are prompting renewed caution and attention to costs in the executive suite. Says Cisco Systems CEO John T. Chambers: "Most of the CEOs I talk with are a little more cautious in their optimism than they were a quarter ago." Because companies are already struggling with rising health insurance and other costs, executives are looking first to their payrolls to find savings.

THE STAT

$44 BILLION

Amount that rising gasoline prices have siphoned away from U.S. consumers between December '03 and July '04

Data: Commerce Dept

Why are higher oil prices less inflationary than in the past?

Oil-driven inflation—which prevailed in the bad old days of the 1970s—is far less likely now thanks partly to more astute monetary policy. During the oil shocks of the '70s, the Arthur F. Burns-led Federal Reserve chose growth over inflation-fighting, unleashing unusually generous stimulus. That "choice that enabled a round of inflation in other goods and services," says Jim Griffin, a portfolio strategist at ING Investment Management.

Equally important, "with energy costs rising and with competition intense, few businesses can afford to pass these cost increases on to their customers," says Peter S. Cohan, an investment and management consultant in Marlborough, Mass. True, many businesses now have more pricing power, but that's in comparison to more than two years of outright deflation in consumer goods when prices outside of services were actually falling. Although yearly inflation, measured by the consumer price index, rose to 3.2% in June, core inflation, which excludes energy and food, is still running at a modest 1.8%.

How do higher oil prices affect the employment picture?

The "oil tax" is increasingly becoming a tax on job growth. The sharp slowdown in the economy in the second quarter and in payroll jobs in June and July is easily the most surprising development in the economy this year. Even the Fed acknowledged the oil link, after its rate hike on Aug. 10. "This softness likely owes importantly to the substantial rise in energy prices," the Fed's Open Market Committee said in a statement.

The job and inflation effects of oil are closely related. Because labor now plays an increasing role in cost control, higher energy outlays only add more pressure to keep profits up by controlling labor costs. That means higher oil prices will be one more incentive for companies to stretch their productivity gains. "Given very limited pricing power and the rising costs of energy and health care, businesses continue to emphasize productivity first and hiring second," says Sung Won Sohn, chief economist at Wells Fargo Bank. With labor's weakened bargaining position in recent years, Sohn says, "the higher price of oil should be viewed as a deflationary, not inflationary, factor."

THE NEW OIL SHOCK

Data: Energy Information Administration, Commerce Dept., Labor Dept.

How will businesses respond to costlier energy?

Energy is just one more cost for businesses to deal with at a time when shareholders are relentlessly demanding better profits. Moreover, it also comes as productivity is slowing. The Labor Dept. reported that productivity posted a healthy 2.9% advance in the second quarter, but that increase was slower than in recent quarters at a time when rising benefits costs are pushing up labor compensation.

As a result, unit labor costs last quarter rose at the fastest quarterly pace in two years. If prices fail to keep up, then margins will get squeezed and companies will be forced to find new efficiencies, most likely at the expense of jobs. One example: "The high level of oil and natural gas prices has become a new reality for the chemical industry, and it will continue to exert pressure on margins," says J. Pedro Reinhard, chief financial officer at Dow Chemical Co. Dow hopes its prices can keep pace with rising costs, but it also plans to unload 3,000 employees in 2004, in addition to 3,500 in 2003.

What is the impact on consumers?

The "tax" on household spending falls disproportionately on middle- and low-income folks—and the companies that cater to them. That's because energy is a necessity that is a relatively larger portion of these families' budgets. In the first half, households coughed up an extra $44 billion on gasoline. That rise alone accounted for 26% of the overall increase in consumer spending. The additional dollars spent filling up the tank mean less for other things. "Any extra money we spend on gas, we used to spend on entertainment," says Robert Tanner, a music professor at Morehouse College in Atlanta.

Retail sales took a big hit in June and July, especially at the likes of Wal-Mart Stores Inc. and discount stores that attract lower- and middle-income shoppers. Same-store sales at Dollar Tree Stores Inc., for example, declined 0.2% during the first half vs. the same period last year. Grouses Adam Bergman, director of investor relations at the Chesapeake (Va.)-based chain: "We are hurt by high oil prices because people are giving their extra dollars to Exxon."

What about the impact of high oil prices on the auto industry?

So far gas-guzzling sport-utility vehicles continue to sell briskly—but at growing costs to the Big Three. They are being forced to slap on increasingly outlandish incentives: Try up to $6,500 on a Chevrolet Tahoe. That's bad news because Detroit gets most of its vehicle profits from SUVs and trucks. Meanwhile, truck-based SUVs are losing favor as consumers trade them in for more fuel-efficient, car-based SUVs made mostly by foreign auto makers. Sales of entry-level, small cars could be hit, too, because such models are purchased by low-income drivers, the people hit hardest by higher oil prices. Detroit isn't asleep at the wheel, though. It's introducing fuel-saving technology on its bigger vehicles and rolling out car-based SUVs.

> The "oil tax" burden falls disproportionately on middle- and low-income folks and the companies that cater to them

How is the runup in oil prices playing in the stock market?

Except for energy shares, not well. T market's view of oil prices has chang dramatically. "It wasn't long ago th everybody was betting that oil was goi to go from $38 down to $32, at least, a now it is $45," says Henry J. Herrm chief investment officer of Overland Pa (Kan.)-based Waddell & Reed Financ Inc. Herrmann says it's not so much t level of oil prices that is spooking i vestors, it's the upward trend.

As a result, there's growing concern th higher energy costs are slowing earnin growth. The spike has reminded investo of the need to be wary of the unexpecte "It is not that the market is saying t damage from current oil prices is systen or irreversible," says Christine A. Calli chief market strategist at Bessemer Tru "It is the risk that oil might be $50 or $ and that higher oil prices increase t probability of a spontaneous recession."

How will oil influence Fed policy?

Fed officials lean toward the belief th pricey oil disrupts economic growth mo than it generates inflation. Still, when t Fed raised its target interest rate by a qua ter-point, to 1.5%, on Aug. 10, it gave sign that it was about to deviate from i planned series of interest-rate hikes duri coming meetings. Although policymake noted the impact of oil, they argued th the economic slowdown will prove sho lived. However, if oil prices stay high or higher, and if the slowdown in the econ my and employment persists, the F would undoubtedly back away from i "measured" pace of policy tightening.

So what does all this mean for the U.S. and global recovery?

Oil is still cheap by historical standards ter taking inflation into account. And t U.S. is twice as energy efficient as it was the 1970s. However, as recent jobs a

owth data show, it is not immune—even oil at $40 per barrel. A supply disrup-n of only about 2 million barrels per day, ghtly greater than the existing spare obal capacity, could push oil to $65 per rrel, according to Waltham (Mass.) con-lting firm Global Insight Inc. That ould be enough for world growth to fall 2.7% in 2005, down from about 4% this year. Even if oil prices hold at their current levels, U.S. expansion will suffer at a time when the nation's economy needs all the growth it can muster to boost hiring.

No doubt, high oil prices are taking a toll and will continue to do so. Indeed, every recession since 1970 has been preceded by a sharp runup in oil prices. So long as supplies aren't interrupted, the U.S. and global economies appear able to withstand $40 oil. But the price may be less growth and fewer jobs. And the higher prices go, the fewer new jobs there will be to go around. ■

–By Stanley Reed in London and James C. Cooper in New York, with Stephanie Anderson Forest in Dallas, and bureau reports

COMMODITIES

Are Speculators Driving Up the Price of Oil?

There is no doubt most of oil's huge price leap—up 40% in the past year, to $45 a barrel—is grounded in fundamental supply-and-demand issues. But how much of crude's big bounce is also because of speculation—hedge funds and other financial players pushing up the price in futures markets? That's tougher to answer, but these traders are surely adding froth to an already superheated market.

New players are helping to push up the volume of crude-oil contracts traded on the New York Mercantile Exchange (Nymex). Such trades are on their way to an all-time record this year, up 13% through July. Data from the Commodity Futures Trading Commission show that the amount of money flowing into commodity funds—many of which include a good chunk of oil investments—has surged whenever the stock market has swooned over the past five years. Today there are more than 3,200 funds registered with the CFTC, almost twice the number in 1999.

Most of the speculators, moreover, are betting that prices are going even higher in the short term. So-called noncommercial traders—hedge funds and other financial players that don't use or produce oil—added 7,453 contracts of crude-oil futures and options on the Nymex as of Aug. 3. And their purchases of crude outnumbered their sales by about 79,000 contracts, the largest such position since the first week in June, according to Platts, which, like *BusinessWeek*, is a division of The McGraw-Hill Companies. This recent buying helped propel crude oil prices.

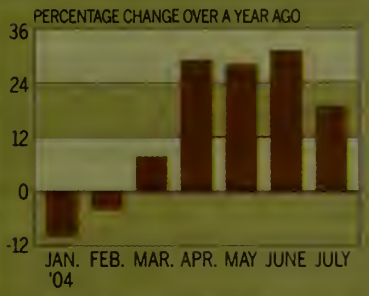
Certainly, financial investors serve an important role in oil markets, making it easier for producers and consumers to hedge risks. An oil company worried that the price of its crude will fall in coming months can sell a contract for December delivery on the Nymex at a certain price, say, $43 a barrel. On the other end of the trade, a commodity fund manager who thinks oil's price will go higher may agree to buy those barrels. If the price rises, the manager will have made money, and the oil company will at least get $43 a barrel.

But that seemingly simple transaction can also inflate the price of oil for consumers, if, say, the money manager wildly outbid others to buy the contract. And he could flip his contract at a higher price to another investor who thinks the recent trade will lead to even higher prices. That can help create momentum for more jumps. Oil users scrambling to hedge prices, such as airlines and trucking companies, are also adding to the frenzy. "Everybody believes there is still some upside," notes Scott Meyers, senior trading analyst at commodities broker Pioneer Futures Inc. "It's very hard to step in front of a freight train."

Thanks at least in part to such trading, today's oil prices might be exaggerating the market risks, some players believe. Consider that a barrel of oil has roughly the same energy as 6 million British thermal units of natural gas, a ratio that usually keeps the two commodities trading more or less in sync. With natural gas selling at about $5.70 per million Btus, crude ought to be at around $34 a barrel, not $45, notes Fadel Gheit, an oil company analyst at broker Oppenheimer & Co. Moreover, the current U.S. supply of crude—not counting the Strategic Petroleum Reserve—has risen 3.6% over the past year, to 294 million barrels. Based on historical price-to-inventory ratios, crude should be $10 to $12 less per barrel, figures Howard Rennell, president of commodities broker Windham Group Inc. Even the futures market suggests that these high prices won't last. Oil for delivery 12 months from now is trading at under $40.

BUBBLING OVER

Volume of oil contracts traded



Data: New York Mercantile Exchange

SEE-SAW Prices of oil for delivery in a year are under $40

To some that means that the markets—and speculators—are doing their jobs. "The increased activity at this point is providing much-needed liquidity," says James E. Newsome, the new president of Nymex. Adds CFTC Acting Chairman Sharon Brown-Hruska: "If [speculators] do a bad job of predicting the markets, they will lose money. If they do a good job of predicting the markets, they make money."

At $1.6 million per seat, the price of membership at Nymex—which trades a dozen other commodities besides oil—has passed that of the New York Stock Exchange. Whatever impact speculators have on oil prices, one thing is clear: Lots of people want in on the action. ■

–By Christopher Palmeri in Los Angeles

WIDER
Chevy
Trail-
Blazer

TIPPIER
Ford's
narrow
Explore

COMMENTARY

BY DAVID WELCH

Stability Shouldn't Be Optional

Detroit lagged in SUV rollover ratings—and that's a problem it knows how to fix

RUGGED, TOUGH, and as safe as a steel cage. That's the image millions of consumers have bought into for a decade as they made sport-utility vehicles the most popular ride on the road. Drivers feel secure riding up high above everyone else, and they feel safer knowing that their SUV will come through a crash better than, say, a Mini Cooper. Even though it costs $60 or more to fill up a big SUV these days, sales are still humming. Good thing, since Detroit earns the bulk of its vehicle profits from trucks and SUVs.

Now those profits, already under pressure from foreign competition, could be threatened by new concerns about safety. On Aug. 9, the National Highway Traffic & Safety Administration issued its rollover safety test results. While some of Detroit's SUVs scored well, hugely popular models, such as the Ford Explorer and Chevrolet Tahoe, scored near the bottom, each with three-star ratings—out of a possible total of five—and a 28% chance of rolling over in a one-vehicle accident. General Motors Corp.'s Saturn Vue SUV failed the test, prompting the auto maker to recall 250,000 of them. Meanwhile, with a few notable exceptions, SUVs built by foreign auto makers generally fared better, since most of them are built not on a high-riding truck frame but on a carlike chassis.

So, once again Detroit is behind the technology curve, right? Actually, no. The Big Three have the gear to make their moneymakers less likely to flip, including electronic stability systems that can stop a vehicle from sliding or tipping. Right now, such technology is a pricey option on Big Three trucks. But with NHTSA's ratings about to become a potent marketing tool and the agency planning to start testing more car-based SUVs, GM, Ford, and Chrysler need to make anti-rollover technology standard if they are to fend off the likes of Honda, Nissan, Subar and Volvo, which topped NHTSA's list.

Ford Motor Co.'s problem is particularly acute. It recover from the rollover fiasco involving its Explorer SUV and Fir stone tires. Now the safety of the same SUV is being called in question all over again. The Explorer ranked second-to-last. I sister vehicle, the Explorer Sport Trac, was the only SUV test with a worse rating. Says Art Spinella, president of CNW Ma keting Research Inc. in Bandon, Ore.: "It's amazing how oft Ford winds up in this situation."

The Explorer and the Sport Trac have one structural issue th contributed to their poor scores. The track, or width from t front view, is two inches less than that of the Chevrolet Tra Blazer, which earned four stars to the Explorer's three when bo have four-wheel drive. A wider track decreases rollover ris Rollovers typically happen when a vehicle blows a tire, hits bump, or runs off the road onto uneven ground and one side ti up. If the vehicle isn't sufficiently wide, it can roll.

Remedies are on the way. Ford will start offering its Roll St bility Control as standard equipment next year on the Explor and other SUVs. The technology detects when the wheels lift the start of a rollover and applies brakes to individual wheels stabilize the SUV. GM should follow suit, making its own st bility-control system standard on such vehicles as the popul full-size Tahoe, which did as badly as the Explorer in t NHTSA test. And if Ford and GM want to go all out, they cou consider offering side-curtain airbags to protect occupants the vehicle rolls over—now a $500 option on most Ford SU Finally, the Big Three are rolling out more midsize, car-bas SUVs like the Chrysler Pacifica, which scored well.

Detroit's main quandary is that many buyers want the to ing abilities of truck-like SUVs—the models that generally pe formed the worst in the NHTSA test. That's why stability-co trol and high-tech air bag systems should be standard on su SUVs. If auto makers can't get buyers to pony up the extra $8 for such gear, it hits the bottom line. But eating a few hundr bucks per vehicle is a far cry better than failing to boost safety and giving their rivals the edge. ■

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MEDICAL DEVICES

THE WRONG WAY TO RUN A RECALL

Boston Scientific's cardiac stent snafus are making doctors and investors wary

BOSTON SCIENTIFIC Corp.'s handling of its recent coronary stent recall is a case study in how not to respond to a product failure. Since early July, the company has been forced into not one, but three, separate recalls of its market-leading device. Because of a manufacturing glitch, now apparently fixed, the system for inserting the stent into a patient's artery has been linked to 47 injuries and 3 deaths. With the latest recall on Aug. 5, Boston has yanked a total of 99,200 stents.

Now, Boston Scientific Chief Executive Officer James R. Tobin needs to convince bruised investors, wary cardiologists, and anxious patients that the company's finally in control of the problem. That's critical, since nearly 40% of the company's estimated $5.7 billion in sales this year will come from its popular drug-coated stent, which accounts for the bulk of the recall. While Boston, based in Natick, Mass., has already lost market share, its main rival, Johnson & Johnson, has been plagued by its own stent-manufacturing problems, which have limited its supplies. That's why Boston has time to recover. Still, with J&J working hard to remedy its supply woes and a new competitor, Medtronic Inc., planning to jump into the market, another misstep could jeopardize Boston's lead.

The clumsy recall already has damaged the company and its credibility. It was slow to identify the manufacturing technique that caused the problem, and, as a result, issued an initial recall that was too small. Boston's stock, which traded around $43 a share the day before the first recall on July 2, has slid to a recent $33. And Morgan Stanley analyst Glenn M. Reicin figures Boston has lost 10 points of its 70% market share in drug-coated stents.

TOBIN An FDA review could result in more stent recalls

Until the recent troubles, Boston was riding high after introducing its drug-coated stent, TAXUS Express2, in the U.S. earlier this year. That device—which is used to prop arteries open after angioplasty—is coated with a drug that cuts the risk that the artery will become reclogged. J&J had launched the first drug-coated stent in the U.S., CYPHER, a year earlier. Despite that lead, many cardiologists found TAXUS easier to use.

SLIDING CONFIDENCE

But TAXUS has been dogged by a da gerous problem. In some cases, the b loon used in the procedure to insert t stent into the artery doesn't deflate. Th malfunction has also occurred wi Boston's bare metal stents, which are coated with drugs and which also are i cluded in the recall. The balloon proble can be dangerous, forcing cardiologists perform emergency bypass surgery.

INDUSTRYWIDE ERRORS

THE COMPANY says a manufacturi change made in May and June in plan in Minnesota and Ireland has fixed t problem. And improvements over t past year in quality controls should e sure the safety of up 122,000 stents that we made before the manufactu ing fix but not recalled. Sti the Food & Drug Administr tion is reviewing how Bost determined which produ to recall and could demar further product withdraw

While Boston's executiv have been making t rounds to reassure b hospital custome some cardiologists r main wary. Dr. Richa W. Nesto, chairman the department of ca diovascular medicine Lahey Clinic Burlington, Mass., whi uses about 2,900 stents year, says his group will co tinue to limit use of TAXU Says Nesto: "We want to w longer and make sure nothing pops up

It could be a lot worse for Boston. J& manufacturing woes have limited ho aggressively it can court disgrunt TAXUS customers. The FDA sent J&J scathing letter in April citing a series deficiencies in the company's ste plants. What's more, says Merrill Lynch Co. analyst Daniel Lemaitre, J&J's pro lems have slowed the company's develo ment of its next-generation drug-coat stent. That could give a boost to Bosto which will soon begin testing of an i proved version of TAXUS.

Still, J&J says it's ramping up CYPHE production. And with Medtronic likely join the fray late next year, that cou push down prices for the drug-coated d vices, which now sell for about $2,5 apiece. If the competition comes strong, that will be one more reas Boston can't afford another slipup. ■

–By Amy Barrett in Philadelph

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STOCKS

TAKING A GANDER AT GOOGLE

As the IPO approaches, its allure is wavering. How do things stand?

AUCTIONEER: Page and Br at head offic

BACK IN 2002, TECH INSIDERS cast a hopeful eye toward Mountain View, Calif. There, amid an industry mired in deep doldrums, a group of 500 headstrong engineers were building an increasingly popular search engine and, surprisingly, making money hand over fist. Many felt Google Inc. could be a beacon for the struggling tech sector, its success helping to open the market for entrepreneurs and capital investment. Today, Google is on the verge of its long-awaited initial public offering, but all of a sudden the event no longer seems like the debut of a child prodigy. Google's IPO is surrounded by as much confusion as anticipation. Here's a look at the key issues facing the company:

What's behind Google's diminishing allure?
Sure, some of the dark clouds over Google could be the result of potential investors talking down the company's prospects in hopes of snatching up shares during Google's IPO auction. But the company itself is responsible for much of the recent bad press. Probably most disconcerting to investors and pundits alike is Google's revelation in its IPO paperwork that it may have violated securities laws by allocating millions of unregistered shares to employees and consultants. To rectify the problem, Google has offered to buy back the 23 million-plus shares at a cost of $26 million. The move likely will mollify the Securities & Exchange Commission and state watchdogs, say securities attorneys. But it certainly raises serious questions for investors. If the company managed to flub such a mass distribution of shares, perhaps it is capable of even more costly mistakes.

That's not all. Google's squeaky-clean image also took a hit on July 20, when its top lawyer, David C. Drummond, was notified by the SEC that it is probing his role in possible accounting violations at his former employer, SmartForce, where Drummond served as CFO. At Google, he has helped orchestrate the company's unique IPO process; he also oversees its alliances and acquisitions. A company spokesperson says Google management has "the utmost confidence" in their general counsel.

Where does the IPO process stand?
Google's intricate listing process is finally starting to crank into motion. The first step, registering interested investors, is expected to close on Aug. 12. Those who haven't gone to ipo.google.com by then to sign up won't be able to participate in the public offering. Those who have signed up and selected a bank will be asked to submit their bids—a number of shares and a price per share—as soon as Aug. 13, though possibly several days later.

To prevent investor gamesmanship and ensure that bids reflect real-world demand, Google can close the bidding process at any time and won't announce how long it will last. One Wall Street analyst, however, speculates that it could take up to four days. At that poin Google and its bankers will a gregate the bids to determin the offering price. They wi likely settle on a price slightl below where demand mee Google's supply, as indicated b the auction results, in an effor to generate at least a mil near-term gain for its IPO in vestors. At that point, share will be allocated and the stoc will begin to trade.

> Recent disturbing revelations have raised questions for investors

Have those who missed the registration window lost out altogether?
Not likely. People who invest after the of fering may have just as good a shot a making money on Google as its IPO in vestors. That's the point of this whole ex ercise: to limit the huge first-day pop i IPO prices, which became the norm in th 1990s and benefited well-connected in vestors at the expense of the company. A auction is supposed to predict true in vestor demand more accurately. And b diminishing the first-day jump, the com

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DITED BY RICHARD S. DUNHAM

s the Education Prez Making the Grade?

2000, AS TEXAS GOVERNOR George W. Bush stumped for Presi-ent, his emphasis on shaking up public education reinforced e message that he was a compassionate conservative who ould reach out to America's underclass. As he decried the "soft gotry of low expectations" that limited the horizons of inner-y children, Bush did more than appeal to derate voters. Once in office, he pushed passage of the No Child Left Behind Act early 2002—an achievement that helped publicans wipe out the Democrats' tra-ional advantage on support for schools. But Bush's advocacy of education reform s proved to be a mixed blessing. Local ool boards around the country—joined top Democrats such as John Kerry—are wling about the tough new law. NCLB uires schools to meet performance stan-rds by 2012. But critics, including many al officials, contend the Administration sn't provided the funding or the flexibil-for school districts to clear the bar.

With his sights set on suburban moms, rry has devised an answer. He wants $27 lion to "fully fund" the y, promises more lee-y for states, and backs me form of teacher rformance standards. effect, Kerry is striking argain with teachers: vocating both higher aries and the per-mance ratings their ions abhor.

KERRY wants $27 billion to fund No Child Left Behind

Republicans can dis-ss Kerry's approach disingenuous, but y have a harder time ping with the backlash ong suburban moms who are furious t schools are becoming teach-to-the-t Stepford outfits. Juanita Doyon, a Spa-way (Wash.) mother of four who is ning for state school superintendent as independent, has staked her bid on minating her state's exam. "[The test] s destroyed teaching and academic free-m," she says. Besides the testing issue, ny localities are raising property taxes pay for what critics call the largest un-funded federal mandate of recent times.

The anger and financial pain have hurt Bush's standing as a reformer. In a *Washington Post*-ABC News poll conducted July 30-Aug. 1, 52% of registered voters said Kerry would do a better job on education, vs. 39% for the President. "Most people support the goals of No Child Left Behind," says Allan Rivlin of Democratic polling outfit Peter D. Hart Research Associates. "But many question Bush's follow-through."

Special Scoring for Special Ed

STILL, THE PRESIDENT hasn't ceded the fight. GOP boosters point out that school funding is up 49% since 2001. First Lady Laura Bush, a former teacher, has been talking up her husband's record in swing states. And the Education Dept. has modified its rules to make it easier for schools to measure up—by getting a break on how they score tests from special-ed students and non-English speakers. But Kerry aides say that because of this change, a portion of the 28,000 schools that fell short last year will be given a passing grade—just weeks before the November election.

While education has been eclipsed in the campaign by war, terrorism, and the economy, it can serve as a proxy for candidates' values. "Security moms" may have replaced "soccer moms" as the demographic group *du jour*, but they still have children in school—and they want assurances that government is investing wisely in their futures. Clearly, that's an opportunity for Kerry, but it's also an opening for Bush, who argues compellingly that throwing money at the problem isn't always the answer. ■

–By Alexandra Starr

CAPITAL WRAPUP

THE BATTLE OF THE PRESIDENTIAL WIVES

Republicans are convinced that **Laura Bush** is a bigger political asset than John Kerry's outspoken wife, **Teresa Heinz Kerry.** So in the aftermath of the Democratic convention, which featured a prime-time address by the nominee's wife, the Bush campaign has unleashed the popular First Lady to weigh in on some hot-button issues. Among the topics she recently has tackled during question-and-answer sessions and roundtables with women small business owners: stem-cell research, tort reform, and regulatory relief. GOP strategists think suburban swing voters will prefer Mrs. Bush's calm demeanor and demure manner to Mrs. Kerry's more assertive style. The First Lady also softens the hard-edged partisanship of her husband and the congressional leadership.

TEXAS DEMS: TOO TIED UP TO LEND A HAND

Texas Democratic activists understand why the Kerry campaign is writing off the Lone Star State. It is, after all, President Bush's home, and all of the statewide officeholders are Republican. But state Democratic loyalists took umbrage when the Democratic National Committee proposed that the state party send workers to swing states Kerry has a chance of winning. Texas political operatives pointed out that five Democratic representatives are fighting for their lives in new districts gerrymandered by the GOP. To punish DNC boss **Terry McAuliffe**, Texas Chair **Charles E. Soechting** is considering asking Lone Star Democrats not to open their checkbooks for the national party and instead send funds to Austin.

FINANCE

THEY'RE HIRING IN THE CITY

Investment banks are finding ways to make money despite scarce deals

IT SOUNDS LIKE A TALE OF WOE for Europe's investment banks. One of the biggest takeover attempts in British retail history—retail tycoon Philip Green's $17 billion bid for iconic Marks & Spencer Group PLC—came to naught. A much-anticipated boom in initial public offerings has fizzled. And after a drought that started in 2001, merger-and-acquisition activity remains in a funk. But bankers in Europe's financial capital, the City of London, and its auxiliary, Canary Wharf, aren't crying in their pints. Indeed, Europe's leading investment banks, flush with profits from niche businesses, are adding thousands of employees. Payrolls are being expanded across a number of high-growth areas ranging from derivative sales to advising on private-equity deals. It's a sign of a shift in the investment-banking landscape—and a tribute to the resourcefulness of the bankers.

Overall, investment-banking revenues in Europe for the first seven months of the year were up 8% over last year, to $8.34 billion, according to London research firm Dealogic. That comes even as the level of M&A activity has failed to meet expectations. Although slightly higher than this time last year because of Sanofi-Synthélabo's $63 billion takeover of Aventis, the value of deals is still down 49% from what it was during the boom of 2000. But officials at Goldman Sachs, Lehman Brothers, Merrill Lynch, Morgan Stanley, and Deutsche Bank say they're increasing their head count in London. Britain's Manpower Employment Outlook Survey, a leading indicator of employment trends, shows that banks and other financial institutions have plans to hire more new staff than they have since the third quarter of 1998.

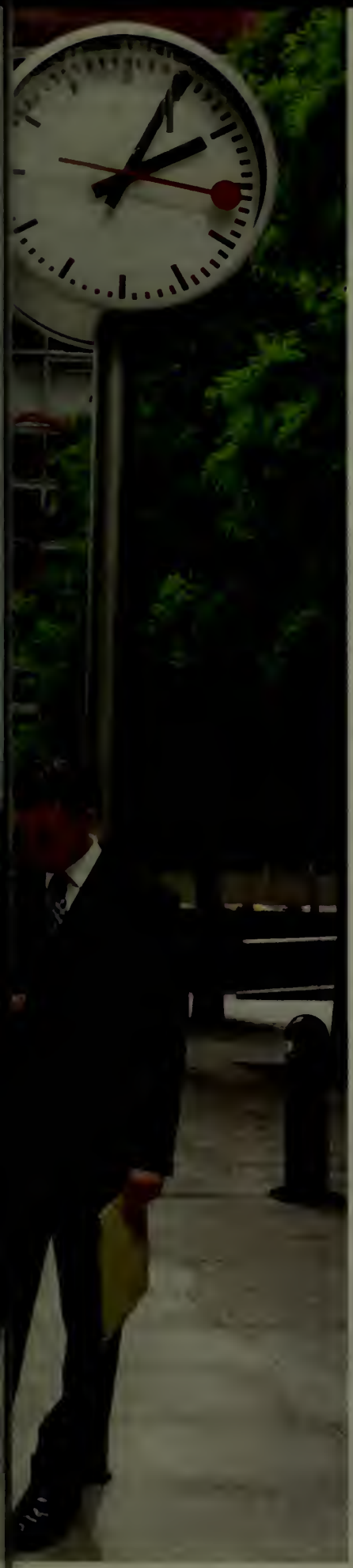
What's different from previous hiring binges is the type of employee the banks are seeking now: derivatives whizzes, asset-backed-security specialists, and private-equity and corporate-debt experts. And Europe's most profitable banks are willing to pay top dollar for this talent. The size of total compensation packages, including bonuses, for senior bankers has increased by an average of about 25% over last year's levels, according to City insiders. Depending on the level of experience, those at the vice-president level are commanding $300,000 to $400,000 a year. Senior rainmakers with proven client relationships are getting $5 million to $6 million. Some banks are even offering one- and two-year guarantees, though not at the rate that they did in 2000. "It has gone from being a flat market to a very buoyant market," says Tara Ricks, managing director at recruiter Joslin Rowe Associates Ltd. in London.

PRIVATE PUSH

ONE OF THE BIG new profit centers for Europe's investment banks is private-equity deals. Turnaround specialists in areas such as British retail and European manufacturing are looking to investment banks to raise money from outsiders for their makeovers. Senior bankers say private equity provided about a third of the revenues for the European investment-banking industry last year. One of the biggest deals in Europe so far this year—Kohlberg Kravis Roberts & Co.'s $2.8 billion buyout of German chemicals concern

CANARY WHARF
Banks are paying top dollar for talent

CHAMUSSY/SIPA PRESS



Dynamit Nobel—involved financing from Credit Suisse First Boston, Goldman Sachs, and UBS. In the months to come, bankers expect to see even more private-equity activity. "They've got plenty of cash, and debt is still relatively cheap," says Alex Wilmot-Sitwell, co-head of European investment banking at UBS in London. "Therefore, deals can be made to work."

Another growth area is asset-backed securities. Europe's demand for these instruments, which repackage commercial mortgages and other loans backed by assets into resaleable bundles, totaled $155 billion so far this year. While that's just one-fifth the size of the $798 billion market in the U.S., it's more than a fourfold jump over five years ago in Europe. Investors like these securities because they disperse the risk of default yet offer a relatively high return. CSFB and Lehman Brothers are among the banks that have been quick to leap into the growing market in Europe—and are hiring more staff to handle the business. Poaching is not unheard of: In June, CSFB hired real estate finance guru Arvind Bajaj from Morgan Stanley to help accelerate its asset-backed mortgage business.

Lehman, meanwhile, served as sole lead manager for the first commercial mortgage-backed transaction in Switzerland last summer. The deal, an $858 million securitization backed by 112 Swiss commercial properties, was done for WTF Holdings, a venture between Lehman and real estate investment firm PSP Swiss Property Group.

That's one trend: manufacturing deals by becoming a full partner in them and taking on some of the risk. Another is to try to get hired as the sole investment banker for particular companies—managing all their assets, debt, and acquisitions. Earlier this year, Lehman bankers advised Danish beer giant Carlsberg on two separate deals: a $3.3 billion repurchase of Carlsberg's own shares from Orkla, a Norwegian food-and-drink conglomerate, which had a 40% shareholding in Carlsberg, and a $550 million stock issue. "It's no longer just about figuring out whether a company should make a divestiture here or an acquisition there," says Jeremy M. Isaacs, chief executive of Lehman Brothers Europe & Asia in London. "It's also about a company's structure. It's a much more holistic approach."

Profits are so strong that even commercial banks are staffing up

Lehman's holistic approach is leading to hefty profits. Helped by gains in Europe, the investment bank saw net income jump 73% in the first six months of its fiscal year, to $1.3 billion, on revenues of $6.1 billion. Profits are so strong that even commercial banks that have traditionally been wary of the volatile investment-banking business are staffing up. HSBC, Europe's largest bank and once known for its culture of Scottish frugality, has brought on about 110 new investment bankers over the last year, 29 of them as managing directors. Barclays Capital Inc., the investment banking arm of Barclays PLC and a specialist in debt financing, has boosted its staff by 19% since last December, to 6,900.

HSBC's investment-banking division has been building up its convertible-bond and project-finance business after the restructuring of its investment-banking and capital-markets unit. Its share of international-bond issuance rose to 4.5% in the first six months of 2004, up from 3.8%, in the first half of 2003. The market for convertible bonds in particular has picked up steam as companies rush to raise funds while global interest rates remain low.

M&A and IPOs? Who needs them? Europe's investment bankers seem to be doing quite well by cashing in on plenty of other varieties of high finance. ■

–By Laura Cohn, with Kerry Capell, in London

It's Not Just M&A

Investment banks in Europe are branching out into new, high-growth areas such as:

PRIME BROKING Extending credit lines to hedge funds, which pay a premium for ready access to cash

DERIVATIVES Hedging currency volatility and credit problems to spread the risk and earn high margins

PRIVATE-EQUITY DEALS Lending to investment groups that specialize in corporate turnarounds

COMMERCIAL MORTGAGE-BACKED SECURITIES Repackaging mortgages for resale in bundles to investors

Data: *BusinessWeek*

AGGRESSIVE STYLE But the station-wagon look is risky

GERMANY

CAN MERCEDES CREATE A WHOLE NEW NICHE?

It's launching the first true high-end crossover, aimed mostly at the U.S.

TAKE A GERMAN LUXURY sedan, meld it with a monster sport-utility vehicle and a versatile minivan, and what do you get? Mercedes-Benz managers hope the answer is a hit. The Grand Sport Tourer, a premium crossover due out in 2005, launches the R-Class, a new Mercedes line designed for maximum roominess and comfort. Mercedes, which will unveil the latest version of the GST in September at the Paris Auto Show, is promoting the car as a segment-buster, a pioneer at the upper end of the growing market for crossover vehicles. "We don't see any competition for the car," says Natanael Sijanta, product manager for the GST. "We put a lot of effort into maximum comfort. That's absolutely new."

Concept models of the near-17-foot GST, which is likely to start at around $66,000, already have created a stir. Designers give a thumbs-up to the edgy styling, including a forward-thrusting shoulder line, muscular wheel stance, and elegantly curved glass roof. But creating a new niche is risky, as Mercedes already discovered with the slow start of its super-mini Smart Car. And buyers have shunned crossovers that were launched without a clear marketing campaign to define the new vehicle concept and its appeal. Mercedes' sister company Chrysler Group, for instance, last year had to offer $4,000 incentives and cheaper stripped-down models of its Pacifica crossover to get the new model moving off its lots. "The challenge to Mercedes will be to establish a definition for the car," says George C. Peterson, president of Auto cific Inc. in Tustin, Cal. "The worst thi that could happen is that people see it the most expensive minivan on the plan

The Stuttgart auto maker insists GST evolved out of consumer resear showing demand for a car with t sporty styling of a sedan, the rugged tra of an SUV, and the spacious interior o minivan. Mercedes limited the number passenger seats to six, in three rows give passengers more leg and elb room. The GST will have the technol and trappings of a high-end Merced including an extra-smooth seven-g transmission. It will be built on the sar platform as the Mercedes M-Class SUV its plant in Tuscaloosa, Ala.

OBSTACLE TO SUCCESS

MERCEDES NEEDS to win a big audien in the North American market, which dominated by light trucks and large ca The U.S. market is likely to repres more than 70% of GST sales, estima market researcher Global Insight In which expects worldwide sales to re 72,600—roughly the same volume Mercedes' top-of-the-line S-Cl sedan—in 2007.

One key obstacle to success could the GST's styling, which is a mix of sle European station wagon and miniva The U.S. market for station wagons i minuscule 250,000 vehicles a year, o 4% of the market, and to date buyers h been unwilling to pay a premium minivans or crossovers. "The tough job of all is to get the positioning rig Americans could say, 'It's not as cool as SUV.' And Europeans could say, 'Hey, i too expensive for a minivan,'" sa Christoph Stürmer, sen market researcher at Glob Insight in Frankfurt.

If Mercedes gets it rig the GST could lead a pivo shift in the design of full-s luxury cars. Some experts b lieve the roomy crossov model line could eventual eclipse the traditional seda But the company will face ju as much competition in t crossover segment as it do in luxury sedans. German vals Audi and BMW both a developing their ov crossover models. To ma sure the GST sets the pa Mercedes will need a tu bocharged launch. ■

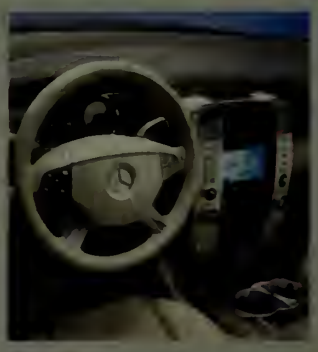
–By Gail Edmondson Frankfi

The Specs on the Grand Sport Tourer

LUXURY CROSSOVER GST will mix features of a premium Mercedes sedan, a rugged SUV, and a versatile minivan

POSH INTERIOR Car is equipped with two entertainment consoles, panoramic glass roof, and considerable leg room

FUEL ECONOMY Diesel or other fuel-efficient motors will help keep costs down



Data: Mercedes-Benz, BusinessWeek

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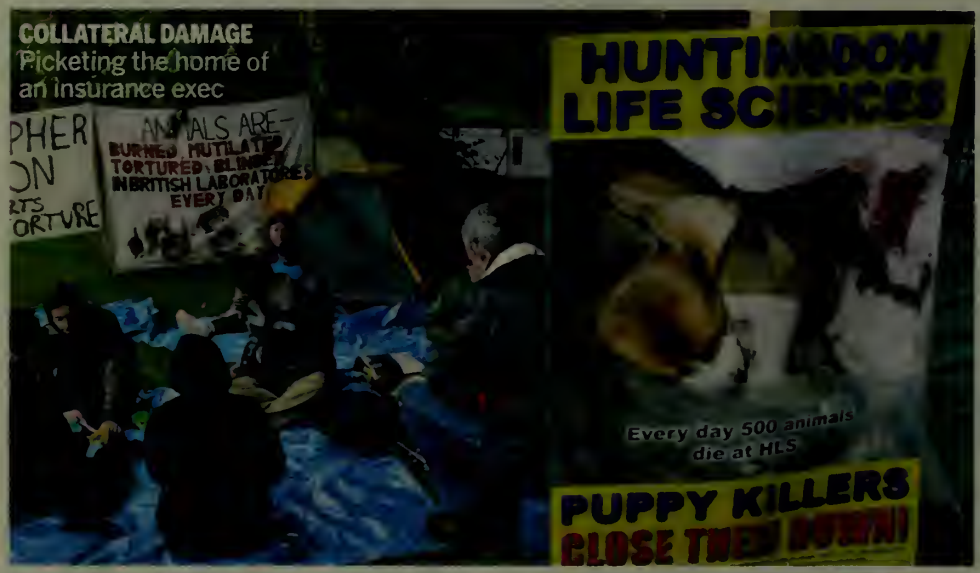
BRITAIN

ANIMAL-RIGHTS ACTIVISM TURNS RABID

Attacks on drug companies and university labs are chilling research



COLLATERAL DAMAGE Picketing the home of an insurance exec

ON JULY 30 THE GOVernment of Prime Minister Tony Blair unveiled its latest plan to combat extremists working in Britain. Irish Republican Army militants? Islamist radicals? No: animal-rights activists.

The term may conjure up images of British matrons collecting donations for the local dog shelter. Instead, think combat boots and balaclavas. This more menacing breed of animal lover is targeting drug companies and university research labs with tactics that range from the bothersome (tire slashing) to the lethal (pipe bombs). Local press reports estimate that these groups are costing Britain $2 billion a year in investment. By tightening existing laws, and stepping up police enforcement, the government is determined to put an end to what Home Office Minister Caroline Flint called "animal extremists' reign of terror."

Britain's $8 billion biomedical research industry is under siege. The country boasts the world's toughest regulations restricting the use of animals in medical research. But that's not enough for groups campaigning for an end to all animal experiments. Attacks and harassment of pharmaceutical companies and university labs—their staff, suppliers, and shareholders—are on the rise. According to the Association of the British Pharmaceutical Industry, there were 235 incidents of criminal damage in the 12 months through June, up from 84 in the previous 12 months. In some cases, Britain's animal-rights extremists are hounding their targets right across the Atlantic, while others are sharing their playbooks with U.S. activists.

After enduring years of abuse in relative silence, British pharma has begun to speak out. "We are being terrorized," said GlaxoSmithKline PLC CEO Jean-Pierre Garnier at the company's July 28 results meeting. Over the past two years, anim rights extremists have targeted GSK's se ior management by staging protests ou side their houses or sending letters neighbors claiming the executives we pedophiles. Garnier says his company h spent "tens of millions of pounds" to pr tect staff and labs from militants.

THE STAT

$128 Million

The amount British pharma spends each year to protect labs from animal-rights protesters

Data: Association of the British Pharmaceutical Industry

HYSTERIA?

BRITAIN'S ANIMAL-RIGHTS militan are increasingly going after universiti which can't afford to spend as much security as big corporations. On July 1 Oxford University was forced to ha work temporarily on a $33 million bi medical lab after construction and eng neering companies pulled out of project, citing damage to their proper and threats to their personnel from an mal-rights extremists.

Activists are savoring their recent vi tories. "You can tell how effective you by how your enemies react—and our en mies are hysterical," says Greg Aver spokesperson for Stop Huntingdon An mal Cruelty (SHAC), a group founded 1999 to target Huntingdon Life Scienc Ltd., once Europe's largest animal testi company. Avery swears SHAC uses on peaceful means of protest. Still, its can paign of harassment against Huntingdc led the company in 2002 to incorporate Maryland, which has more stringer shareholder privacy laws than Britain.

The new law-enforcement measur strengthen harassme laws by, for instance, a lowing police to arrest pr testers demonstrating ou side a person's home. Stil a spokesperson for Britis drugmaker AstraZenec questioned "whether th current penalties will be sufficient deterrent."

The activists, thoug are not staying put. June, the FBI warne delegates at the annu meeting of the Biotec nology Industry Organ zation in San Francisc that it had evidence the group's mem bers were potential targets of extremist In February, biotech Chiron Corp. i Emeryville, Calif., sued SHAC-USA, th U.S. affiliate of the British group, alleg ing its involvement in two pipe bomb ings at Chiron's campus, a charge th group refutes. In the age of the Interne and globalization, local causes quickl ripple across borders. ■

–By Kerry Capell in Londo

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ON A ROLL Posco is investing in high-tech methods and Chinese plants

SOUTH KOREA

POSCO: ONE SHARP STEELMAKER

Highly efficient and profitable, this innovator is set to crank it up a notch

KOREA THESE DAYS ENjoys a well-deserved reputation for its digital prowess: a land where lab-coated engineers and scientists work with delicate wafer chips, while pink-haired youths write software for the latest cell phone. But you don't have to dig too deep to find another Korea, one where hard-bodied workers labor in factories to produce the stuff that makes the physical world go. To get an idea of the vibrancy of this part of the economy, visit the Posco steelworks in Pohang, on the peninsula's east coast. Here, in sweltering heat, sparks fly as molten iron is ladled into vast bins, and ribbons of fiery metal roll through milling machines.

Old Economy? Sure. But Posco is no rust-belt relic. True, with $12 billion in sales, it isn't the biggest steelmaker on earth. That title belongs to Luxembourg-based Arcelor, more than double Posco's size. But where it really counts, Posco is in a class all its own. The company enjoys the biggest profits in the global steel industry, raking in enough cash to make many a high-tech outfit envious. Thanks to robust demand at home and in China, net earnings from Posco's array of steel products—used in everything from screws to skyscrapers—last year shot up 80%, to $1.66 billion. And Daewoo Securities Co. is forecasting a 61% jump in profits, to $2.7 billion, on $15.6 billion in sales this year. "As far as efficiency is concerned, Posco stands taller than any other steelmaker in the world," says Daewoo analyst Yang Ki In.

In fact, Posco isn't as different from South Korea's New Economy innovators as all the sweat and sparks might lead you to believe. The company is considered one of the industry's high-tech paladins. And in August, Posco will enhance that reputation when it breaks ground on a $1.1 billion mill that could boost productivity even higher. The mill will use a new technology, called Finex, that is expected to cut costs by nearly a fifth and harmful emissions by more than 90%, says Chairman and CEO Lee Ku Taek. For decades, steelmakers have used highly polluting ovens to turn powdery coal and iron ore into chunks called coke and sinter, which are melted with superheated air to make iron. With Finex, coal and ore are turned into iron without coking and sintering. After the plant opens, in about two years, Posco plans to roll out the technology in other mills. "I want to be remembered as the CEO who started another leap forward," says Lee, a 35-year Posco veteran who has become the project's champion since taking over the top job a year ago.

Posco has put plenty of slick information technology to work, too. The company has spent $179 million to network its 80 Korean plants so that it can take orders online and coordinate production and deliveries. So, as molten steel slabs wend their way through Posco's mills, each is pressed to a specified weight and width depending on a particular customer's needs. This mill-level customization helps push steel out the door faster, which has enabled Posco to halve delivery times and slash inventories by

Steel Standing

The world's top steelmakers

COMPANY	COUNTRY	PROFITS	SALES
Posco	Korea	1,658	12,022
JFE Holdings	Japan	889	20,568
Arcelor	Luxembourg	323	32,552
Nippon Steel	Japan	-430	22,873
U.S. Steel	U.S.	-463	9,458
Corus Group	Britain	-542	14,144

All results from 2003. $ millions. Does not include LNM Group, a private company that does not report net profits. **Data:** Company reports

CEO LEE KU TAEK

6. "This company has a track record onsistently improving productivity," Park Kyung Min, CEO of Hangaram estment Management Co., which s 8% of its $300 million fund in co shares.

TTING BIG ON CHINA

E THE REST OF Korea Inc., Posco be- es its future lies across the Yellow Sea hina. The country is already the com- y's biggest export market, and Posco invested $800 million in 14 Chinese t ventures. By 2006, the company s some $1.4 billion in fresh invest- t in China, especially in galvanized stainless steel to supply global auto appliance makers that have opened ts there. "With China consuming -quarter of the world's steel, we must ompetitive in the market," says Lee ung Ho, a senior manager at Posco- na Holding Corp., which oversees the pany's mainland operations.

osco does have a few weak spots. The gest: In this age of globalization, the pany still relies on Korea for about of its sales—though it has plans to italize on booming emerging markets India and Russia. And some analysts nder why Posco's clients at home pay rly 20% less for certain products than verseas customers. Is it cutting Kore- a break to keep the government hap- given that Posco controls 55% of do- tic steel sales? Chairman Lee says no. co's low prices, he maintains, are a re- of long-term contracts that domestic tomers signed before Chinese de- nd kicked in and sent prices up. He in- s that the price structure will right it- in coming years—which will give the pany another profit boost. Others ble that, before being privatized in 1, Posco lucked out with sweetheart d deals for its two biggest mills in Ko- Moreover, say experts, as a relatively ng company—Posco was founded in 8—it has low pension liabilities, while government ties have kept South Ko- s militant unions from making in- ds, a distinct advantage over rivals.

erhaps Posco did get some lucky aks early on. But it's hard to deny that lso has a decade-long record of high ductivity and profits. As long as Posco ps delivering 60%-plus earnings wth and attractive shareholder re- ns, few investors will gripe. This is one ean champion likely to be in fighting n for many years to come. ■

–By Brian Bremner and Moon Ihlwan in Pohang, South Korea, with Dexter Roberts in Beijing

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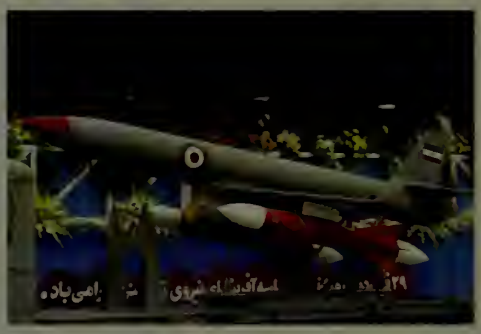
EDITED BY MICHAEL S. SERRILL

Why Iran is Giving The West the Willies

WHAT SHOULD THE WEST do about Iran's nuclear program? That issue will be one of the hot foreign policy questions of September, when the U.N. Security Council and the International Atomic Energy Agency meet to discuss the best way to make sure Tehran does not build the bomb. The Iranians are talking tough: On July 31 they announced they would resume building the centrifuges that can enrich uranium to weapons-grade strength. Iran says it's for peaceful purposes, but the Europeans, who thought they had brokered a deal to stop Iran's march to nuclear power status, are outraged.

So are the Americans. And the Israelis. In early August, President George W. Bush and his National Security Adviser, Condoleezza Rice, said they would demand U.N.-imposed sanctions if Iran persists. Israel has set up a committee headed by the director of Mossad to monitor Iran's nuclear program, which Jerusalem thinks could yield a bomb by 2007, two years ahead of current estimates. Some Knesset members say Israel might eventually need to consider a surgical strike, like the one that took out Iraq's Osirak reactor in 1981. Even the Arabs are uneasy. "Iranian hegemony in the Middle East is feared in many quarters," says Ephraim Kam, a Tel Aviv University strategic expert.



TEHRAN PARADE Can the nuclear push be stopped?

But Iran isn't necessarily worried about any threats. When the U.S. invaded Iraq, Iranian leaders feared Tehran would be the next candidate for regime change. But the Pentagon is so tied down in Iraq that the odds of a military operation to oust the mullahs are near zero. The U.S. "is not going to be in a position to leverage or threaten anyone," says Jon Wolfsthal, an arms-proliferation expert at the Carnegie Endowment for International Peace. U.N. sanctions might be vetoed by China or Russia, two of Iran's nuclear suppliers. And Iran has probably scattered its nuclear sites across its vast and mountainous terrain to thwart any Israeli attack.

Interwoven interests

FINALLY, IRAN is not a collapsed state like North Korea, whose only bargaining chip is its nuclear menace. Iran's oil production is a vital part of the world energy picture, and it has extensive commercial relations with Europe. Europe's governments may denounce Tehran for its nuclear ambitions, but at the same time Renault and Volkswagen have signed large deals with local companies. Amir Mohebian, an editor of *Resalat*, a conservative Tehran daily, believes that neither Europe nor the U.S. wants to cut off dialogue with the Iranian government. "The Iranians feel they're on a roll," says Steven Everts, senior research fellow at the Centre for European Reform in London.

That confidence, adds Everts, could prove misplaced. He thinks the West will be forced to respond with stiff sanctions if Iran builds a bomb. Is there a way out, now that both the Europeans' diplomatic approach and the Americans' hard-nosed tack have failed? One option, analysts say, is for them to switch roles, with Europe playing the bad cop by advocating sanctions and the U.S. holding out the carrot of diplomatic relations in exchange for ending the nuke program. If Washington shows that kind of flexibility, "it increases the chances of Europe supporting a more robust course of measures later," says Everts. That's the hope. But success is hardly assured. ■

–By Stan Crock in Washington and Neal Sandler in Jerusalem, with Laura Cohn in London, and Babak Pirouz in Tehran

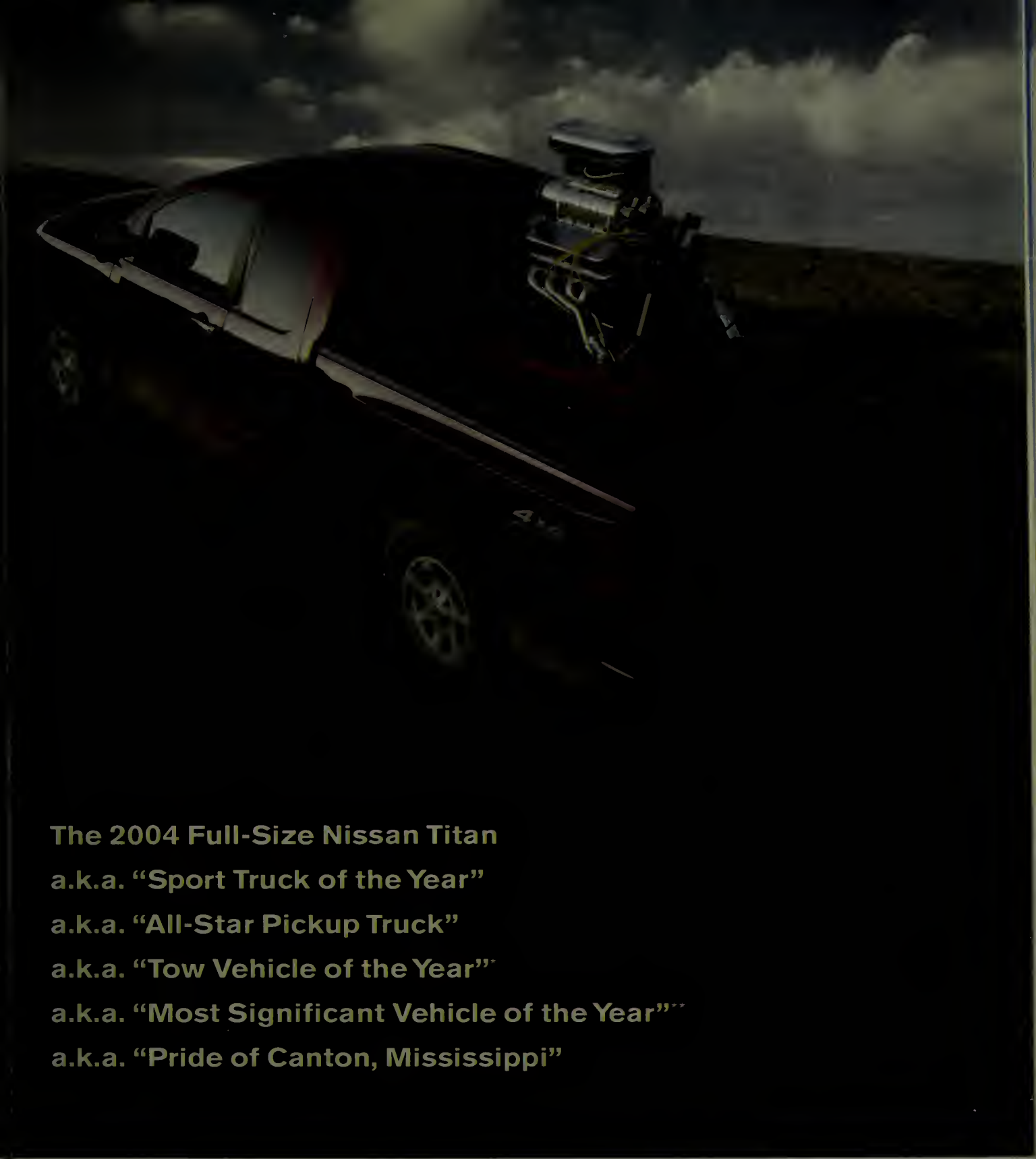
GLOBAL WRAPUP

VENEZUELA'S HIGH-STAKES VOTE

POLITICAL LEADERS at home and abroad are hoping the Au 15 recall vote on Venezuela President Hugo Chávez will bring some stability to the oil-rich nation. But unless one sid or the other wins decisively, is not in the cards. As the fate day approached, support for t populist Chávez, whose public approval rating once fell below 30%, rose toward 50%. That's because he is spending hundreds of millions of oil dollars social programs for the poor. The diverse and fractious opposition was suffering from the lack of a single leader to present as an alternative to the charismatic former paratroope If the result is close, deep-seate political tensions could explode into bloody protests.

THE SARKOZY EXPRESS STRAIGHT AT CHIRAC

CAN FRENCH Finance Minister Nicolas Sarkozy be stopped? Sarkozy is a big favorite to become head of President Jacques Chirac's center-right Union for a Popular Movement (UMP) later this year and has made clear he would use the post as a springboard to run fo President in 2007. Chirac is trying to block him, most recently by threatening to fire him as Finance Minister if he becomes UMP chief, making it harder for him to build a track record. But UMP leaders are pressing Chirac to reconsider. Eric Raoult, vice-chairman of the National Assembly, told *Le Monde* on Aug. 12 it would be "damaging to lose [Sarkozy's] talents." Even Roselyne Bachelot, a European parliamentary deputy who was spokeswoman for Chirac's 200 reelection campaign, says Sarkozy should be allowed to hold both jobs.



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a.k.a. "Pride of Canton, Mississippi"

/e named it the Titan. But thanks to the hardworking people at the new issan plant in Canton, Mississippi, it has other monikers, too. In *Sport Truck* agazine it goes by "Sport Truck of the Year." It's called "All-Star Pickup uck" in the pages of *Automobile Magazine*. Clearly, the state of Mississippi's ultimillion-dollar investment in job training has paid off, resulting in a whole of great trucks. And more than a little pride.

MISSISSIPPI | NISSAN

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ccess

WORK HARD. PLAY HARD. STAY FIT. THAT'S A MANTRA for today's executives. Whether it's driving a Porsche 996 GT3, fishing at the Drynachan Lodge in northern Scotland, or eating a great rib eye at Mahogany Prime Steak House in Omaha, a rich, balanced life is a life worth having. But it is one that is increasingly difficult to attain. Rarely have executives faced so many uncertainties in their professional and personal lives. Stress is ubiquitous and often overwhelming. It can threaten performance and undermine health. ¶ *BusinessWeek*'s new Executive Life issue is a guide to restoring some fun and balance to an exec's harried reality. You'll find tips on hiring a trainer to get the body fine-tuned and doing meditation to clear the mind. There are out-of-the-way places to visit, including the very private Fisherman Island, off the coast of Maine, and faraway places to stay, such as the private villas and palaces of Morocco, with their own cooks and housekeepers. ¶ For execs looking to upgrade their own spaces, *BusinessWeek* offers advice on building a home theater, putting together a private gym, and even remodeling the entire manse. The dog days of summer are upon us, but there's still plenty of time to have fun. ■

NEIL RABINOWITZ/CORBIS

These Retreats Offer You Privacy—and Cater to Your Every Whim

Havens

YOU'VE BEEN THERE. IT'S THE VACATION SPOT THAT LOOKS SO luxurious and peaceful in the brochures. Your suite is plenty spacious and perfectly cooled. The resort boasts all the amenities you had hoped for. But head to the spa, the pool, or the five-star restaurant, and you're overwhelmed by noisy children, boisterous teens left alone by their parents, or worse. Turns out that the calm and peace you left home and office for has eluded you. ¶ You can't exactly rent the entire hotel and make it into your own private oasis, but you can come close. Increasingly, well-heeled travelers are bypassing mainstream resorts and booking private villas, islands, castles, and estates. Not only do these exclusive retreats offer privacy, but they often come with a full staff, including cooks and housekeepers. For the traveler who spends most days at a demanding job, an escape to one of the following private getaways could be just the ticket to rejuvenation.

–Jennifer Merritt

A Casbah Escape

Luxury Beckons in Morocco

HAMPTONS TOO TRENDY? COTE D'AZUR too packed? Tuscany too full of *trattoria* menus in German? As more exotic locations attract upscale travelers, Africa has become a hot spot. But the continent isn't all safaris and camp huts. Morocco, for one, is using its rich heritage and a new attention to luxury to lure travelers.

This pro-Western Arab and African nation is about as exotic—and romantic—a destination as you will find within a two- or three-hour flight from Europe or seven hours from New York. Luxurious accommodations are accessible, too, thanks to Villas of Morocco, a rental agency specializing in private villas and palaces (contacts: villasofmorocco.com; Tel., 44 207 823-2255; e-mail, reservations@villasofmorocco.com).

Set up last year by 32-year-old Youssef Benamour, a former Morgan Stanley investment banker from a prominent Casablanca family, the London agency can open the doors to such wonders as the Al-Ghalia Palace in the medieval city of Fez. The palace, which rents for $17,000 a week, has five bedroom suites and a staff of 10, including two cooks. Dar Iman is a huge villa in an oasis next to Marrakech, the medieval walled city that started attracting jet-setters such as designer Yves St. Laurent back in the 1970s. The complex, with an Olympic pool, is a favorite of French film star Catherine Deneuve and will set you back around $20,000 for a week of utter luxury. Steep, but then again, you're getting an entire compound with a staff of 15. You can even hire a part-time or live-in nanny during your stay.

When you've spent a day poolside, the big attraction is roaming around the endless labyrinth of the Marrakech souk. It can be noisy and even infuriating—when, for example, you have to make way for motor scooters and donkey carts in narrow lanes. But it's a feast for the senses, from the pungent spice market to the gleaming brass and colorful silks. You can finish up the expedition drinking mint tea on the rooftop terrace of the Café de France, looking at the sun setting behind the Atlas Mountains.

Villas of Morocco also handles more modest offerings, such as Dar Al-Arsa, within the old casbah of Marrakech. The elegant mansion, with its marble inner courtyard, is a haven of peace at the center of one of the most fascinating cities of the Islamic world. With three large bedroom suites, Dar Al-Arsa rents for just $3,500 a week. It includes a live-in cook who will happily prepare local specialties such as baby lamb with almonds and lemons, and Tariq the butler, who is always at hand with refreshing glasses of fragrant mint tea—the national beverage.

Benamour's agency takes most of the potential hassles out of a Moroccan vacation. Guests are met at the airport and escorted through customs. Staff help not only with restaurant reservations but also with suggestions about historic sites to visit. Chauffeur-driven cars can be easily arranged. "People want to relax when they come to one of our properties," says Benamour. Spending a week like a Middle Eastern potentate can bring down the stress levels of any overworked exec.

–John Rossant

Rugged Pampering

On a high in Jackson Hole

OH, GIVE ME A HOME WHERE THE BUFFALO roam. Or at least let me rent one like Rancho Alegre Lodge, a seven-bedroom, 10,000-square-foot house in Jackson Hole, Wyo. It's perched on a butte surrounded by 50 acres of pristine meadow. (If you don't spot any buffalo, you might catch sight of some elk.) But the real appeal lies in a jaw-dropping view of the Teton mountain range and its miles of snow-capped majesty. "When you are on the property, you feel like you are in the middle of nowhere," says Lisa Husband, an event planner with Destination Jackson Hole. "It's just very magical."

Rancho Alegre may be remote, but it's not lacking in luxuries. An $11,700 weekly rate gets you one meal a day, a scrumptious breakfast prepared by a personal chef who uses fresh eggs and organic vegetables grown on the grounds. The house sleeps a maximum of 22, and the weekly rental fee includes two on-site staff members at your beck and call 24 (ranchoalegre.com; 307 733-7988).

The master suite is decorated with European antiques and a small woodburning stove. The main room has a more Western feel with animal heads, a pool table, and French doors that open onto a spacious deck. A cozy library, featuring oak floors, cherry bookshelves filled with everything from classic novels to cu

SYBARITIC
Stretch out with Villas of Morocco

t fiction, and a tile fireplace, is there to give rest to the weary. tside is a barnyard, whose permanent residents include two ats, a pair of lambs, and several dozen chickens.

Beyond the ranch, adventure awaits. In the summer, Jackson le is known for hiking, horseback riding, fly-fishing, and itewater rafting on the Snake River. The region also features ee ski resorts, including the world-famous Jackson Hole ountain Resort, which opens this year for skiing and snow-arding on Dec. 4. "The Big e," as it bills itself, is known for challenging terrain, including nation's longest continual ver-al drop at 4,100 feet. But Jack-Hole Mountain has also been proving its options for interme-te skiers and children.

No trip to the region would be mplete without a visit to two of nation's greatest attractions. and Teton National Park, with 13,000-foot granite face, glacial es, and wildflower meadows, is miles away. Yellowstone Na-nal Park, home of Old Faithful, 55 miles away. Want some cul-e? A summer concert series esents classical music four hts a week until mid-Septem-at the 740-seat Walk Festival ll near Teton Village. Rock and lers might check out the Mangy ose, where the likes of Little

TETON VIEW
Skiing, anyone?

Feat and Dickey Betts will be appearing in September.

Back at the ranch, Wyoming Balloon will deliver a hot-air balloon (and pilot) for aerial views of the mountains and valley at a cost of about $200 per person. At night you can cozy up outside the lodge and toast marshmallows at Rancho Alegre's fire pit while gazing up at the stars. *–Christopher Palmeri*

Island Solitude

An Historic Maine Getaway

WHEN GEORGE AND SUSAN CRAIG SAW a for-rent ad in the *New York Post* featuring an idyllic island off the southern coast of Maine, they decided to give Fisherman Island and its seven-bedroom stone house a try. George, a bond trader, Susan, a former attorney, and their three children fell in love with all 68 acres of the private retreat—from the richly appointed home to a 300-year-old cottage thought to be one of the oldest still-standing structures in Maine to the patches of wild berries waiting to be picked. Two years later, in 1997, the Craigs bought the island for just over $2 million from a businessman who had restored the home and island a few years earlier, after it had long been used as a religious retreat.

The family treks to Fisherman Island from southern Connecticut two or three times a year, staying up to two weeks at a time. But most of the year you can rent it through Hamburg, Germany-based Vladi Private Islands (vladi-private-islands.de; Tel. 49 40 33 89 89)—just be sure to book early for prime summer slots. For $19,200 a week, you and up to nine guests get use of the entire island. In addition to the 5,000-plus-square-foot main house, the property features a heated saltwater pool, a sauna, and deck hammocks. A chef is on hand to prepare all your meals (he'll contact you before you arrive to cull a list of your favorite foods). There's full maid service, and your own personal boat captain stands ready to take you fishing or ferry you to the picturesque town of Boothbay Harbor on one of the island's three boats—including a 34-foot cabin cruiser. Since even in summer, temperatures can dip into the 50s, you can light two massive stone fireplaces in the 60-foot-long great room (complete with pool table, several couches, and a foosball table). From every window, you'll have water views.

Fisherman Island appeals to families—often extended families—who return year after year. But the quiet island isn't for everyone, says Susan Craig. If you're looking for spa treatments or constant entertainment, you

The Critic

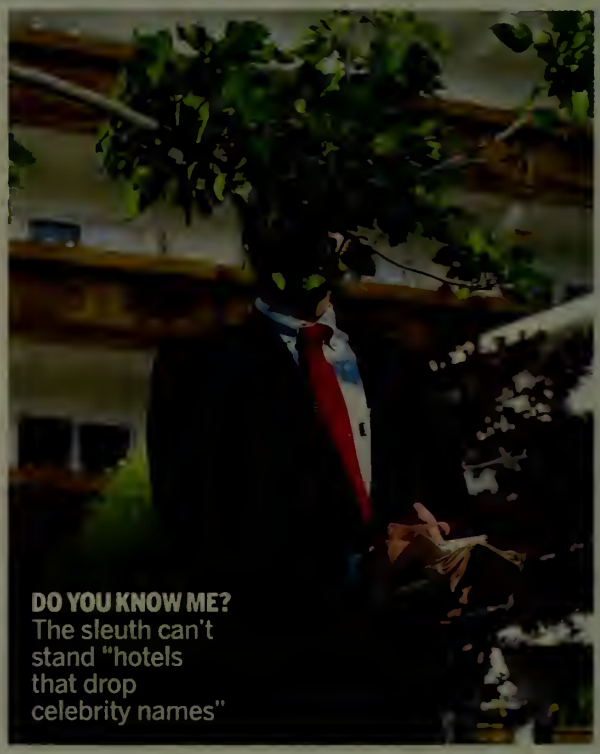
Andrew Harper Roams Incognito To Review Top Destinations

TRAVEL ENTHUSIAST ANDREW HARPER has spent 25 years ferreting out the best and worst in luxury travel for readers of his monthly *Hideaway Report* (andrewharpertravel.com). Harper, who uses this pseudonym in his writing so he won't be recognized at the places he reviews, recently spoke with Associate Editor Diane Brady about his experiences on the road.

Why did you start the *Hideaway Report*?
I came up with the name when my wife and I were at yet another disappointing destination—something we had read about that wasn't at all like the description. It made me think there must be a market out there for a publication that covers peaceful and unspoiled places, but mentions the good things and the warts, too. I travel under my real name and pay the same rate as everyone else. We accept no advertising. It works. I never thought honesty would be such an unusual trait.

Who is your typical customer?
Over 93% are 45 to 65, and they tend to be successful. But most of them have earned their wealth rather than inherited it, so they know the value of a dollar. They want to go to places that are a bit out of the way. Like me, they cannot stand hotels that drop celebrity names. The fact that Ben Affleck stayed at a hotel does not make it great. More than anything else, they're looking for personal service. That's the heart and soul of a hotel.

How has the travel landscape changed over the past 25 years?
People today are far more adventurous than they used to be, in part because there are more boutique hotels in exotic locations. One of the pioneers of that was Adrian Zecha with Amanresorts in Asia. Oberoi Hotels has done the same thing in opening up India, one of the last great frontiers. Like Aman, they have a wonderful sense of place. It's not like the old Ritz-Carltons, where you would see the 18th and 19th-century equestrian prints no matter where you were. The world is opening up, and more people have the disposable income to travel.



DO YOU KNOW ME? The sleuth can't stand "hotels that drop celebrity names"

What are the consequences?
The future isn't all that bright. You're going to see more people pouring into these places. I think the world will become more homogeneous and less exotic. If you want to see a place like Costa Rica, you better do it in the next five years because development is booming.

Have some destinations improved?
Sure. Let's take Bali, which has had a lot o boutique hotels move in. It still has thos wonderfully mystical highlands. The peo ple have held on to their values. They tru ly believe their island is a pantheon of gods

For me, one of life's last great adven tures is an African safari. The experienc is never the same and where else can yo venture forth into a primitive world de void of modern-day pretensions? I te people to go to East Africa to experienc that epic annual migration of more than million wildebeest. The Serengeti is awe some. For something different, I would g to Botswana to the Okavango Delta area

Which places are overrated?
Tuscany is a beautiful area but I don' think it will hold on for much longer You do see a lot of Americans, and som people will look for quiete places. But it's all relative t the time that you're living an traveling. Where Tuscan might not be as appealing t me as it was 10 years ago someone else who goes ther for the first time might find i fabulous.

One destination that disap pointed me was China. Durin the Cultural Revolution, Ma obliterated that country's her itage. I go to places like Hon Kong and Singapore, and don't quite get it. I see all th stores I see back home, onl there are eight of them. An Russia, aside from St. Peters burg, is really quite gloomy t me. You can see the despair an disillusionment that years of to talitarian rule have wrought. was also disappointed i Jerusalem. Here you have a rea spiritual epicenter, and ther was an air of discontent.

Any bright spots?
There are so many magical places. Big E Lodge in Montana is truly incredible. love colonial Mexico. The Hotel La Perl in the Dolomites of Italy is somethin else. In Morocco, La Gazelle d'Or is a be guiling place. What's nice is that wit more money and better infrastructur more people will experience places lik Patagonia. Travel really is the best educa tion. My advice is, if you want to see place in the world, don't wait. ■

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PATHFINDER Extreme biking at Red Mountain Spa

Spas

Facilities Are Wooing Execs with Programs That Aim for Lasting Results

BY LAUREN YOUNG

NOEL GARTMAN DESCRIBES HIMSELF AS A WORKAholic and a "Coke-guzzling, pizza-eating, nonhealth nut." Not exactly a spa kind of guy. But last year—after he was hospitalized for stress-related shingles, after a colleague in his early 40s dropped dead of a heart attack, and after Gartman hit the big Four-O himself, the Birmingham (Ala.) software executive decided he needed to focus seriously on his health. Where did he start? At Canyon Ranch Health Resorts in Tucson, a place where ladies who lunch too much still go to shed pounds, and where hard-driving "Type A"s once wouldn't be caught in the light of day.

But spas like Canyon Ranch, which also has a facility in Lenox, Mass., have been reaching out to executives just like Gartman. In February, Gartman checked into Canyon's 18-month-old Executive Health Program for 10 days of lifestyle therapy. By adhering to the diet-and-exercise regimen he received, he has firmed up his middle and lost 20 pounds. He also sleeping better and no longer has migraine

While executive spas offer an escape from the daily grin you won't be lying on a massage table all day with cucumber over your eyes, although you will get your fair share of pam pering. Just as in the office, participants set goals—albeit pe sonal ones—and must work hard to achieve them. Some pr grams are tailored to the individual; others appeal to teams executives. No matter where you go, the objective is self-im provement and better health. "An enormous number of exe utives die before they reach retirement," says Connie Tyne, e ecutive director of the Cooper Wellness Program, a Dallas sp "We want to make them understand why it's happening."

Of all the plans that are geared to executives, medic spas, which number about 65 in the U.S., are the mo popular. At the heart of such programs is the physical exam. key component in detecting and preventing health problem

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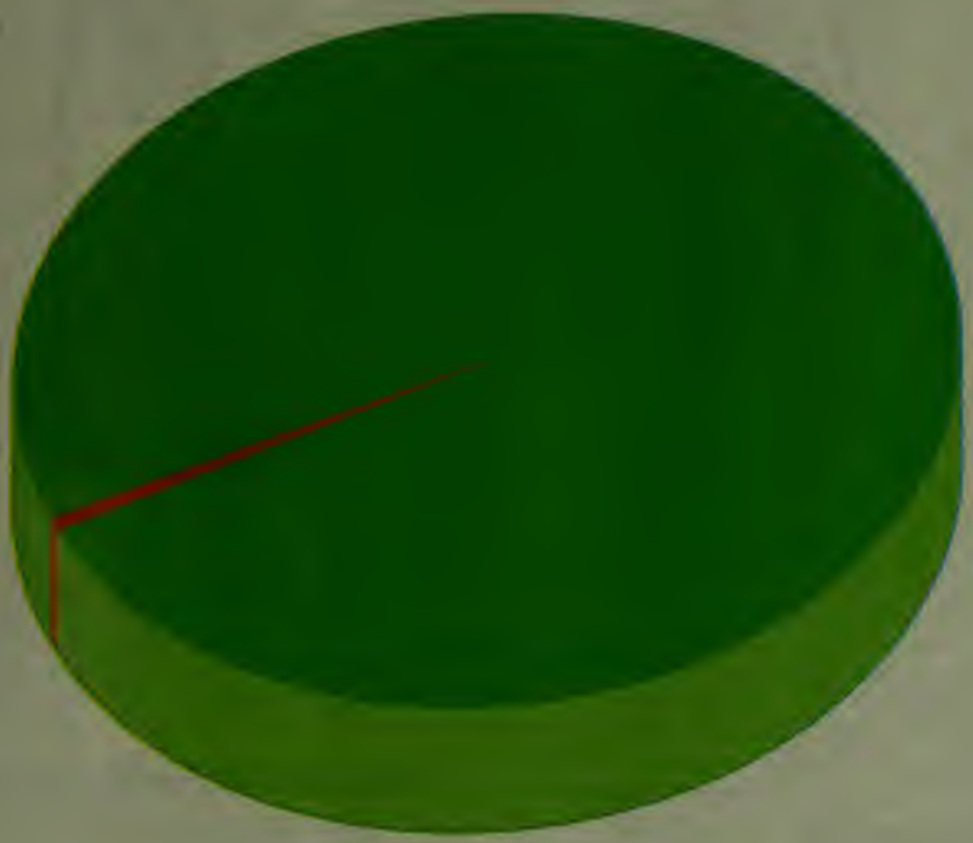

Yes.

No. Do I look like I was born yesterday? Next you'll be telling me that all the computers in the world are connected to each other by some sort of "electronic superhighway." Go sell your tall tales to somebody else, Jules Verne.

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in stressed-out execs.

Sure, you can get a physical from your doctor, but it's more enjoyable if you integrate it into a vacation. Even better is the amount of time devoted to all the poking and probing. Former guests at Cooper Wellness say the medical workup there is unlike anything they've ever experienced before: It's common to spend several hours chatting with one of the clinic's 19 doctors, each of whom sees just four patients a day. The Cooper exam includes blood work, urinalysis, an electrocardiogram, a treadmill stress test, a chest X-ray, a pulmonary function test, and underwater body-fat analysis.

» Most medical spas won't force-feed you information on fad diets

MORE PUNCH Boxing class at Canyon Ranch

At most medical spas, you won't be dealing with crackpot doctors. Nor will you be force-fed any information on fad diets. Scientists studying the Pritikin Longevity Center & Spa in Aventura, Fla., for example, have collectively published more than 90 reports about its diet and exercise programs in top medical journals. "It's all anchored in the latest science," says Jeffrey A. Sonnenfeld, associate dean for executive programs at Yale's School of Management and a recent Pritikin guest who has lost 30 pounds.

The reams of information provided on topics such as nutrition and cardio fitness appeal to detail-oriented executives. At Pritikin, you'll sit through four hours of lectures—ranging from label reading to decoding your lipid profile. *Chicago Sun-Times* movie critic Roger Ebert, who credits the Pritikin center with helping him lose 90 pounds in the past 20 months, calls the program "a combination of Harvard and the boot camp of spas."

POOL MEDIC A consultation at Pritikin

Yet a heavy dose of pampering sets these spa getaways apart from the medical programs that are affiliated with universities and hospitals such as the Mayo Clinic. Canyon Ranch in Tucson, where the Executive Health Program costs $3,200 for four days, plus meals and accommodations that start at $2,030 per person, double occupancy, focuses on the mind, body, and spirit. In addition to all the health information, you can get a hot-stone massage or a mango-sugar scrub, play tennis, and attend a pottery class. Even though Canyon Ranch's methods are rooted in Western medicine, participants are encouraged to explore alternative therapies such as acupuncture.

Customization is key to the executive spa experience. About a month before your visit to Canyon Ranch, a registered nurse will call to discuss your goals and begin devising a personal health plan. On arrival, expect to spend 80 minutes with a staff doctor getting a physical exam and discussing your medical history. You'll also consult with a nutritionist and an exercise physiologist. Such extensive face time with staff, who outnumber guests 3 to 1, "is crucial in figuring out what makes someone tick," says Dr. Mark Liponis, Canyon Ranch's corporate medical director. "You get to learn a lot about their health and lifestyle."

FIND YOUR INNER ARNOLD

EXECUTIVE SPAS ALSO OFFER AN alternative to the standard golf outing for a company group. To strengthen the bond among staff at Kisco Senior Living, 40 executives from the Carlsbad (Calif.) retirement facility operator went on a high-tech treasure hunt at Red Mountain Spa in April. The group used global positioning systems to find clues on the spa's 55-acre property in St. George, Utah. At the end of the day, some of the participants piled into the spa, which stays open until 1[illegible] p.m., for massages and facials. "I was able to leave behind the stress and worries from my job and focus on myself and my team," says Kirsten Jewell, director of healthy strides at Kisco Senior Living.

Make sure you assess the difficulty of activities before you sign up. Red Mountain, which bills itself as "the Adventure Spa," is best known for hiking, biking, and rock-climbing programs. While couch potatoes might enjoy the experience, someone who is already in good shape will make the best use of the surrounding 57,000 acres of parklands featuring breathtaking red sandstone cliffs.

Nemacolin Woodlands Resort & Spa, in Farmington, Pa., meanwhile, lets executives get in touch with their inner Arnold Schwarzenegger. At the resort's distinctive Off-Road Driving

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GOOD EATS At Cooper Wellness in Texas

Spa food has had a bad rap, but it's not tofu and bean sprouts

Academy, you can drive a Hummer H1 or H2 vehicle through 20 miles of terrain with every obstacle imaginable—muddy ponds, precarious 31-degree side slopes, and steep inclines (including 22-inch vertical steps). How does that translate into a spa experience? The program "is all about feeling the power that's underneath you," says Jordan Weyand, Nemacolin's director of recreation.

If you are looking for an Outward Bound kind of adventure, New Age Health Spa in Neversink, N.Y., approximately a two-hour drive from New York City, offers an extensive ropes course with a five-story climbing tower. Participants, wearing harnesses tethered to a rope controlled by teammates on the ground, explore their strengths and abilities. Miraval Spa in Tucson has guests work with horses to discover the behaviors that affect their personal and professional relationships, both positively and negatively.

NO CELL PHONES, PLEASE

ASIDE FROM THE ACTIVITIES, the main thing executives care about is grub. While spa food has gotten a bad rap, you won't subsist on tofu and bean sprouts. "The food at Canyon Ranch is to die for," says Betty Price, 57, a government consultant in Vienna, Va., who recently stayed at the Lenox location. She's hooked on the blueberry pancakes and brownies.

Even the low-salt, low-fat Pritikin diet has been overhauled with more protein. Guests dine on roasted lobster, wild mushroom risotto, and grilled bison. "I'm a taste guy, and it actually tastes pretty good," says J. Timothy Gannon, senior vice-president at Outback Steakhouse Inc. in Tampa, who has cut his cholesterol an blood sugar since h started visiting Pritiki in 1998. Keep in min that some spas shun alcohol and caffeine So make sure you check the policy if yo can't get by without your morning jolt o evening martini.

Before you pick a spa, figure out ho much structure you want. You don't have a much flexibility at a program like Coope which always starts on a Sunday, and when you'll be assigned to a group of 12 to 18. Th group dynamic isn't a factor at Canyo Ranch. You can start and end your Execu tive Health Program when you please.

Unless you consider self-help to b work, do not expect to have much of working vacation at some executive sp programs. The exception may be if you getaway is structured as a corporate retreat Canyon Ranch bans cell-phone usage out side of guest rooms. However, Pritikin an Cooper Wellness build time into the day fo guests to get some work done.

You don't have to be a senior executive to attend an execu tive spa. These programs are simply geared toward busy peo ple willing to spend serious time devoted to their health, un der the watchful eye of experts. (Check spafinder.com for a lis of programs.) That kind of attention comes at a price: Coop er's program starts at $2,295 for four days. The price include classes and meals, but not accommodations, spa services, o the medical exam, which alone costs about $2,400. At Pri tikin, physician consultations, lab tests, nutrition/exercis classes, stress workshops, lodging, and meals are part of on all-inclusive price, which starts at $3,000 (single occupancy) for one week. Not bad, but then again, the average stay is two weeks.

ROUGHING IT A Hummer off-road at Nemacolin

You might be able to get your company to foot the bill. Larry Malcolmson, president of MD Buyline, a medical database provider in Dallas, sent one overweight employee who constantly called in sick to Cooper Wellness. "He has not missed a day in two years," Malcolmson says, adding that he plans to enroll more employees. (About half of Cooper's guests are sent by their employers.) "You get a big return on what I believe is a cheap investment," Malcolmson says. Even if your company won't spring for your stay, your health insurance may cover the cost of some of the medical tests. Now would n't you rather have your blood drawn in a luxurious spa set ting than in a doctor's office? ■

BusinessWeek online For a Q&A with movie critic and Pritikin fan Roger Ebert, as well as more information on executive spas, go to www.businessweek.com/execlife

Office of National Drug Control Policy

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Delicious Finds Across the Country—from Fried Eggs To a Lobster Feast

Dining

AS CUSTOMERS, EXECUTIVES TEND TO BE A DISCERNING and demanding lot. After all, it's their job to accept nothing but the best, while keeping a firm eye on the bottom line. With that in mind, *BusinessWeek* asked a few of the nation's corporate leaders to recommend their favorite restaurants. The results (on pages 90 to 96) should appeal to a variety of palates and budgets. Indeed, our execs include a vegetarian, and their picks range from a diner, where you can get breakfast for $3.19, to a steakhouse with a $186 entree—for 36 ounces of lobster. Aside from good food, all these spots share two key ingredients: an emphasis on service and a warm, friendly atmosphere. Some of our subjects have even struck up friendships with the staff or owners of their favorite haunts. So, the next time you're in New York, Omaha, Philadelphia, Chicago, or Dallas, check them out: Who knows, you might even bump into a CEO. *–Anne Tergesen*

RICHARD FREEDA/AURORA

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IN GOOD HANDS

Ed Meyer

A Restaurant Hound Finds Respect at SoHo's Fiamma

ED MEYER IS QUICK TO CITE THE HALLMARKS OF A great restaurant: an eclectic crowd, a memorable interior, sumptuous but recognizable food, and that feeling of being special. "There's nothing more destructive of a good meal than being abandoned halfway through," says the chairman, president, and CEO of New York marketing and advertising giant Grey Global Group. As someone who has invested in several Manhattan restaurants, such as Smith & Wollensky and The Post House, he ought to know.

But Meyer does have some favorites among the competition, such as the three-year-old Fiamma Osteria in Manhattan's SoHo district. "It's Italian, and it's glorious!" says Meyer. He likes the feeling of privacy that comes from Fiamma's townhouse setting and what he describes as "fresh and clean Italian food." Among his favorites is the hand-rolled garganelli ($22), which is covered in a creamy sauce of Fan Daniele prosciutto, spring peas, and truffle butter. "It's the kind of dish you can't find anywhere else," he says. "I'm absolutely hooked on it." While Meyer normally avoids dessert, he also admits to being a sucker for the crocchette ($10), which are small amaretti and ricotta beignets (doughnuts) that come with a range of dipping sauces.

A self-described restaurant hound who eats out five nights a week, Meyer has a strong sense of what he's seeking in a meal. "I'm not looking to eat obscure parts of the animal," he says. "I like regulation cuts of meat prepared a little differently." And please give loyal customers a little respect. As Meyer puts it: "To be greeted like a stranger on your fifth visit is not something that creates an affectionate bond between me and the restaurant." Maitre d's, mind your manners. *–Diane Brady*

Fiamma Osteria, 206 Spring St., New York, N.Y. (212 653-0100)

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Mellody Hobson

A Steak House's Side Dishes Bring a Vegetarian to the Table

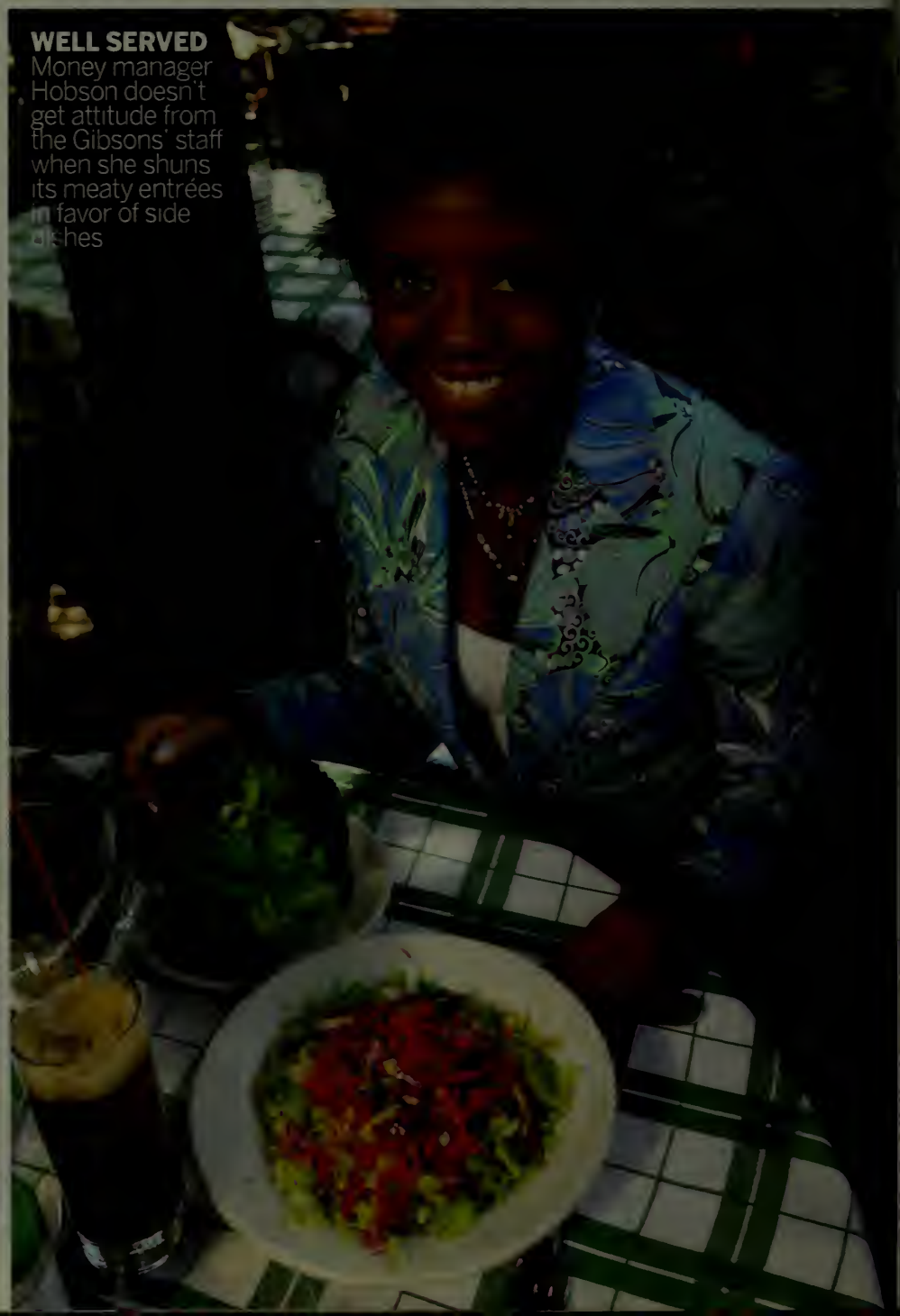
IT ISN'T EASY TO BE A VEGETARIAN IN CHICAGO. FROM the shwarma grilling in the Middle Eastern restaurants on the North Side to the sizzle of hot dog stands on every street corner, meat is king in the Windy City. Chicago, after all, was the meatpacking capital of America for years and it's still the center of cattle futures trading. The city's love for carnivorous fare makes dining all the more challenging for Mellody Hobson, 35, president of Ariel Capital Management, a Chicago money-management firm. Hobson has been a vegetarian for five years.

Hobson's aversion to meat makes Gibsons, one of the city's best-known steakhouses, an odd choice for her favorite dining establishment. But the reason Hobson prefers the restaurant on Chicago's Gold Coast is simple: "They have the biggest sides." She's drawn to the "gigantic" servings of steamed broccoli ($5.50) as well as "the really excellent" spinach sautée with mushrooms and garlic ($11.50). Hobson also is a fan o Gibsons' garden salad, loaded with chopped carrots and othe fresh veggies dressed with a balsamic vinaigrette ($4.50).

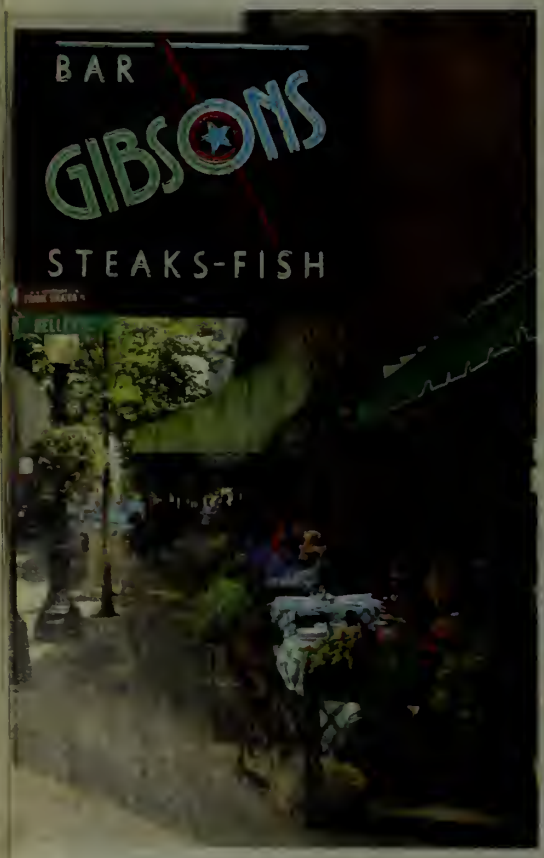
Aside from the bountiful portions, Hobson frequents Gib sons because the staff never gives her attitude for shunning en trées. "Most fancy restaurants get annoyed if you just ge sides," Hobson says. It's also an ideal spot for entertainin clients. "Gibsons has great energy," she says. It's not exactl quiet, but you can still carry on a conversation. When she visit the restaurant in warmer months, she prefers to dine outside o the patio.

Gibsons has a reputation as a place that's buzzing with chi Chicago locals. So Hobson, who was recently featured in *Vogue* spread on successful, stylish women executives, fits righ in. Yet despite her taste in expensive clothes, she is decidedl down to earth. After all, she eats her veggies. *–Lauren Young*

Gibsons Steakhouse, 1028 N. Rush St., Chicago (312 266-8999)



WELL SERVED Money manager Hobson doesn't get attitude from the Gibsons' staff when she shuns its meaty entrées in favor of side dishes



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John Bogle

Vanguard's Penny-Pinching Founder Loves His Local Diner

JOHN C. BOGLE IS A NOTORIOUS CHEAPSKATE. AS founder of the Vanguard Group, one of the nation's largest mutual-fund companies, he brought low-cost index investing to the masses and ran the company with an eye constantly on cost-cutting.

So while other Philadelphia executives are breaking bread at the Union League and the Four Seasons Hotel's Fountain Restaurant, Bogle's power breakfast spot is Benny's Place. It's a bustling, 185-seat diner around the corner from the city's new National Constitution Center, where Bogle has served as chairman since shortly before retiring from Vanguard in 1999.

Bogle orders two eggs over easy, home fries, and a couple of slices of rye toast, washed down with several cups of regular coffee. For $3.19, "the price is right," he says. Bogle's favorite part of the meal is the fried potatoes, which, he says, "aren't loaded with junk" like onions and peppers. "I like the crispy part," he says. So far he hasn't ordered anything else: "I never want to break up a winning combination."

Bogle, 75, underwent a heart transplant in 1996 and admits the meal isn't exactly the cornerstone of a heart-healthy diet. "My cardiologist encourages me to 'eat my heart out,' but only on special occasions," Bogle says. That's why his visits to Benny's are limited to several a month, when he meets with Constitutional Center staffers or friends.

The ambience at Benny's may not match the city's tonier eateries, but Bogle says the service certainly does. He likes how the servers never leave his coffee cup empty. Despite his penny-pinching reputation, Bogle pays up for good service: While a 15% gratuity on $3.19 is a mere 49¢, Bogle usually tips $2.

–Lauren Young

Benny's Place, 435 Chestnut St., Philadelphia (215 574-3663)

Joe Moglia

A Discount Broker Finds Upscale Happiness in Omaha

DOES IT SURPRISE YOU THAT JOE MOGLIA, CEO OF Omaha-based online discount broker, Ameritrade likes a good deal? That's why he heads two or three times a month to Mahogany Prime Steak House. It's across the street from one of Omaha's landmarks, the orphanage that's now a program for at-risk kids called Girls & Boys Town, immortalized in the 1938 movie *Boys Town* starring Spencer Tracy and Mickey Rooney.

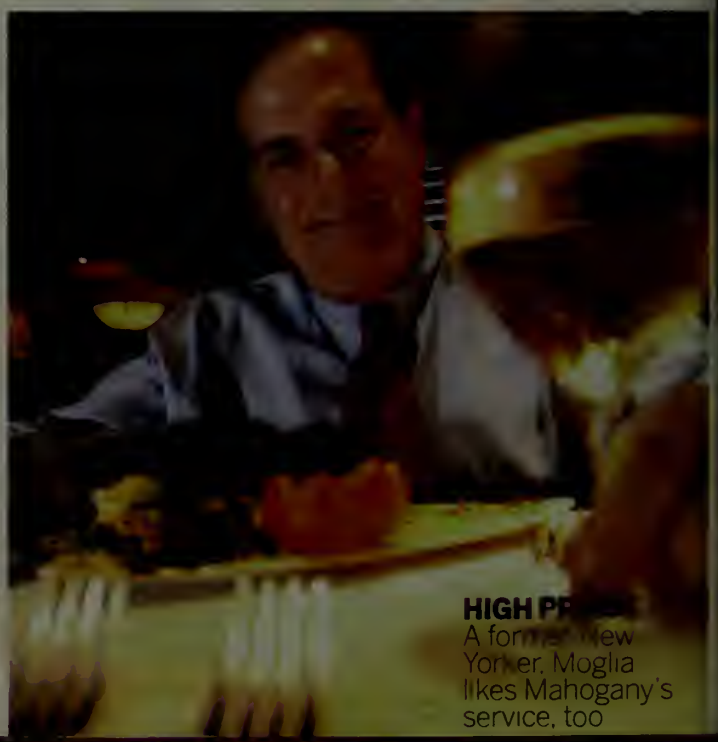
It's not that Mahogany Prime is cheap. In fact, it's one of Omaha's pricier establishments, featuring entrées such as the "prime cowboy rib-eye steak" and Chilean sea bass at prices that range from $18.99 to $49.99. But "you get a lot for your money," thanks to the high-quality food and service, says Moglia, whose firm is known for $10.99 online trades.

One of Moglia's favorites is the Australian cold-water rock lobster tail. From the seas off the southern coast of Australia, it's more dense than the Maine version—and more flavorful, Moglia says. Mahogany Prime also serves one of the best steaks Moglia has had, a 16-ounce bone-in filet. "The juice from the meat bubbles on your plate when it comes out."

A transplanted New Yorker, Moglia discovered a kindred spirit in Mahogany Prime's general manager, Dan Esch, who got his restaurant education at New York's Tavern on the Green in the early 1990s. "The second time I came in, he knew who I was, and I've gotten to know him since," Moglia says. The CEO also appreciates the restaurant's attention to detail. The chef selects a featured bottle of wine each night, and the servers are attentive and well-trained, he says, yet not intrusive. That's high praise coming from a guy who knows a thing or two about running a business.

–Anne Tergesen

Mahogany Prime Steak House, 13665 California St., Omaha, Neb. (402 445-4380)



HIGH PR
A form[illegible] New Yorker, Moglia likes Mahogany's service, too

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Herb Kelleher

An Entrepreneur Favors a Friend's Mediterranean Bistro

LOYALTY TO AN OLD FRIEND IS ONE REASON SOUTHwest Airlines Chairman Herb Kelleher puts Al Biernat's at the top of his list of favorite restaurants. But tasty steaks and seafood and warm service—not to mention the ability to sneak a smoke at a table near the bar—bring him back every two or three weeks. "Al's a great person, very hospitable. He doesn't think [customers] are a burden—not like a United flight attendant," laughs Kelleher, whose low-fare airline is famous for its friendly service.

Biernat's place has become something of a celebrity hangout, attracting the likes of football star Troy Aikman and singer Julio Iglesias. The owner graciously greets all his customers, famous and not so famous. He is especially fond of Kelleher, whom Biernat first met when he was general manager of the Pal restaurant in Dallas. It was legendary entrepreneur Kelleh who encouraged him to start his own restaurant. Biernat h even hunted quail and deer on Kelleher's West Texas ranc "He's successful, but he wants everyone around him to be su cessful," says Biernat, who opened his sunny-yellow, Medite ranean-style establishment in Dallas' Oak Lawn neighborhoo in 1998.

On a recent day, Kelleher occupies his usual spot in a boot near the front. Ignoring the city's anti-smoking law, he puts a ashtray on the seat and sneaks some puffs of his Merit Ultim cigarettes. The only time he's interrupted is when a local a chorman stops by to say hello.

Kelleher starts his lunch with his usual Bloody Bull, a Blood Mary with bouillon. Then it's on to a $6.95 cup of hearty tortill soup, followed by peppered beef tenderloin with cognac glaz and garlic mashed potatoes for $18.95. He orders his tenderlo rare and jokes that even if he gets mad cow disease, "with m behavior, nobody will even know I have it." There's no low-ca dieting at Kelleher's table. For dessert, he gulps down the warm chocolate cake with molten center ($7.95). After thanking hi waiters and kissing the hand of the hostess, Kelleher heads bac to work. *–Wendy Zellne*

Al Biernat's, 4217 Oak Lawn Ave., Dallas, Tex. (214 219-2201

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Wine

How to Find the Best Values When Dining Out

BY JAMES E. ELLIS

HOWARD ROSENCRANS MAKES HIS LIVING COMBing the stock market for hidden values. But ask Rosencrans, president of New York investment research boutique Value Advisory, to do the same on a restaurant wine list, and he's no longer a master of the universe. "Selecting a wine can be incredibly daunting," Rosencrans says. "There's no uniformity and, price-wise, it's just about the biggest crap shoot on earth."

Such is the maddening world of restaurant wine, where even a savvy exec like Rosencrans can end up clueless. One reason: There are few "deals" on wine lists. Unli a local wine store, restaurant prices usua ly include big premiums to help pay f the serving staff and the real estate. Ma restaurateurs use high wine prices to ke food prices low. And, yes, a few recogni that, once a diner is seated, they have captive market—and price accordingly.

All this can translate into 100-to-200 markups over the retail price of m wines, with generally the biggest pren ums on the least expensive wines. A 20 Mezzacorona Pinot Grigio that retails $9 costs $24 at Washington D.C.'s O Ebbitt Grill, for instance. So it's up to t diner to develop strategies to get the mo grape for the buck.

NOSINESS PAYS

FINDING VALUE IN WINE is more tha just selecting the lowest-priced bottl "Value means the quality of the win meets or is under the price," says An Davis, wine and beverage manager f Hilton Hotels' restaurants, including Fin & Porter and St. Louis Fish Market.

Most of us—especially those who ente tain for business—loathe the prospect frantically searching for value on a li while dinner guests and sommelier solemnly await our pronouncement. A littl sleuthing before you leave home can eas the anxiety. Michael Green, wine consultan to *Gourmet* magazine, suggests you view restaurant's wine list on the Internet c have it faxed to you in advance. "A menu i often one page and can be perused in thr to five minutes, but a wine list can be dozen pages," he says. That extra time wi also allow you to compare retail prices an reviews on Web sites such as zachys.co sokolin.com or winespectator.com.

If you arrive at the restaurant hot an parched, don't sit down to the table an quickly order wine. You'll probably drin more, but enjoy the wine less. Win should be savored and used to comple ment the taste of your meal, not simply t slake your thirst, brewski-style. Instead starting with a $7 bottle of water for th table could save you having to buy an extr $70 bottle of chardonnay later.

When you open the wine list, look fo something familiar, which you can use as a mental price refer ence. Widely carried wines such as Robert Mondavi Napa Val ley chardonnay (about $23 retail) or nonvintage Veuve Clicquo Champagne (about $40 retail) are good for this. Paul Birchall general manager of the Luxe Hotels in Beverly Hills and Bel Air Calif., considers double the retail price of a wine he recognize to be good value. "Much above that—and there are restaurant that charge up to four times the retail price—you're just being stung," he says.

You can often save big by trying a bottle made from a less ex

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Wine List Strategies

1 **PLAN AHEAD** Check a restaurant's wine list on the Internet, or have it faxed to you in advance so you can compare prices, selection, and value.

2 **ORDER SMART** Ordering by the glass or half-bottle is smart if you want only a smal amount of wine. But underestimate your consumption, and you'll end up paying more.

3 **TAKE A CHANCE** Less popular or unfamilia varietals are often better deals. Substitutin a sauvignon blanc for a chardonnay or a shiraz for a cabernet sauvignon can save you money without sacrificing taste.

4 **HIT THE ROAD** Try bottles from less familia regions such as the Pacific Northwest, Australia, Argentina, or South Africa, wher high-quality wines usually cost less.

5 **GET HELP** Ask the sommelier or wait staff for suggestions. Be sure to indicate your price range.

pensive grape. With whites, a sauvignon blanc or a pinot gris often works just as well with fish or light pastas as a chardonnay. At 21 Club in New York, for instance, you could safely substitute a $38 Hunter's Sauvignon Blanc Marlborough 2002 for the $80 Grgich Hills Chardonnay without losing much zest. For reds, consider a shiraz (also known as syrah), zinfandel, or Argentine malbec instead of the usual pricey cabernet sauvignon. One smart swap at Washington's Ceiba: the $26 Altos Las Hormigas Malbec for the Estancia Cabernet Sauvignon at $38.

Even if you're wedded to a particular grape, you can often hold down the cost by buying from a less celebrated region.

» Restaurant markups can run as high as 200%

Australian chardonnays, for example, can easily be 20% cheaper than comparable American bottles. Lower-priced New Zealand sauvignon blancs may even be of better quality than their U.S. counterparts. "It's like buying an apartment in Brooklyn instead of Manhattan," says Green. "There's better value."

Avoid ordering marquee wines such as a first-growth Bordeaux or California cult cabernets. They're best left to collectors, the truly well-heeled, or Tyco-style expense account drinkers. A bottle of 1983 Chateau Margaux that retails for $379 at D. Sokolin Co. in Bridgehampton, N.Y., costs $750 at 21.

If one diner at your table wants to try a white while everyone else drinks red, try a half-bottle rather than buying a whole bottle for one person. But plan wisely: You'll pay at least a 10% premium for the smaller quantity. So if you order a second half-bo tle, you've wasted money. The same can hold true when orderi multiple drinks by the glass.

Don't forget that sommeliers or even your servers can gui you—if you give them proper direction. Be sure to indicate wh food you're ordering, the type of grape or style (fruity, dry, et you prefer, and what you'd like to pay. If you're leery of talki price in front of dinner guests, Green suggests you "discreet point to the price of a bottle rather than to the name of the wi and ask the server to recommend something like this." All b the most dense waiters will get the message and suggest bottl near that price, while your guests will be none the wiser.

Some diners finesse the situation by frequenting restauran that allow you to bring your own bottles. Girasole, an Italia charmer in Los Angeles' tony but laid back Larchmont neigl borhood, lets you grab a bottle at the wine shop next door. Eve Chez Panisse, the Berkeley (Calif.) restaurant considered one the original temples of nouvelle American cuisine and whic boasts an ample cellar, lets you bring your own for a $20-pe bottle corkage fee, with a maximum of two bottles.

Be careful. Restaurants charge up to $30 for corkage, an some frown on the practice if the bottle you bring is on their wi lists. So call ahead to check. Moreover, unless you're bringing pricey bottle, it's not worth the effort if there's a stiff corkage fe and it offers a range of its own bottles at less than $45.

Just remember when perusing any wine list that high quali and high price are not synonymous. "You don't have to spen $100 to have a good wine," says Jerry Evans, owner of the his toric Jacksonville Inn in Jacksonville, Ore. which has more tha 2,000 wines on its list. Indeed, Evans is currently praising a su prisingly inexpensive $14.95 Columbia Crest Reserve Shiraz o his list as an excellent food wine. Evans figures that by pushin value to guests, his restaurant will have more satisfied custome and sell more wine. Now that's smart planning. ■

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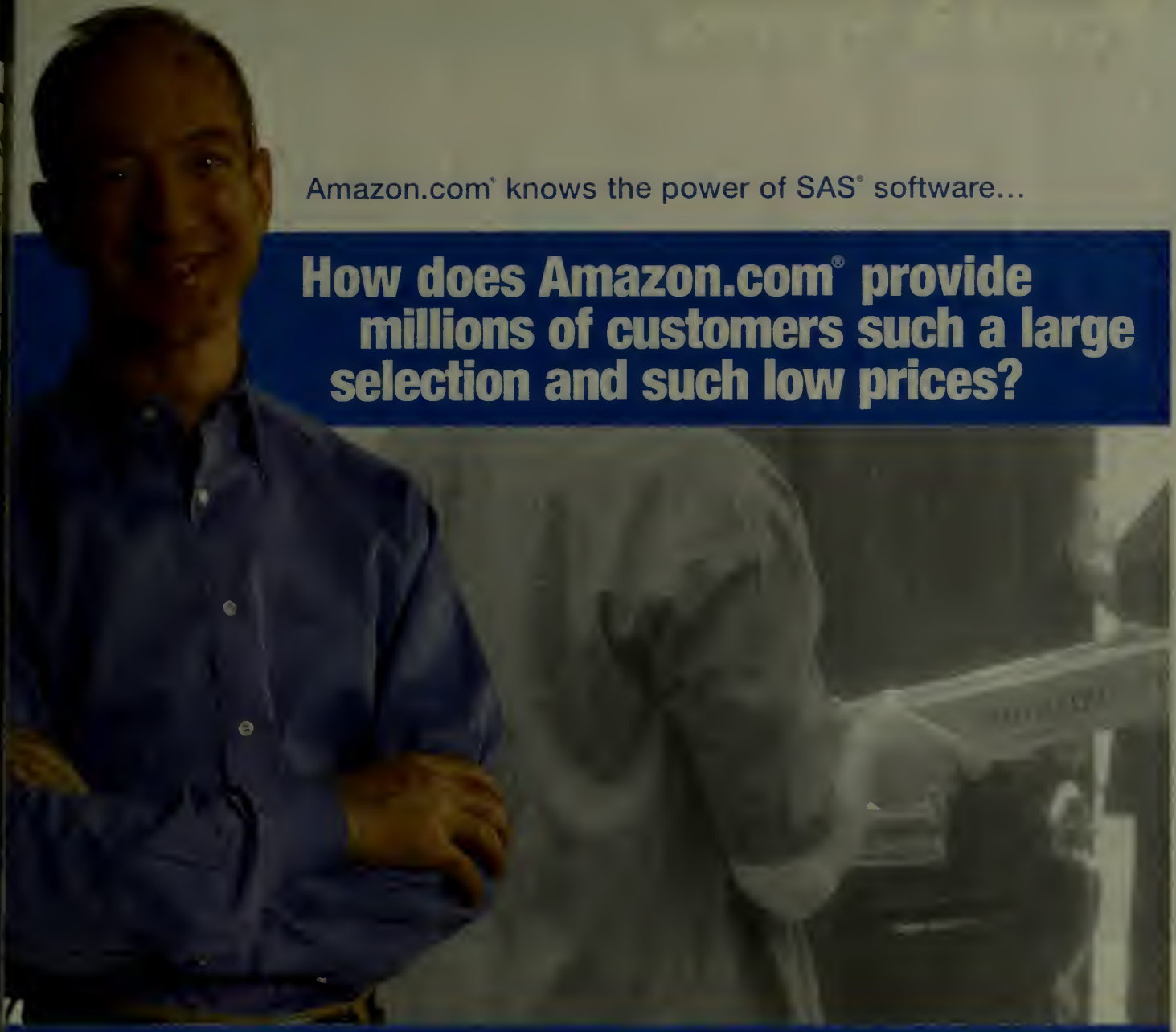

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THE DIVA DRINKS

Cocktails

Audrey Saunders Has Revived Bemelmans Bar in New York with Classic, Quirky Drinks

BY GERRY KHERMOUCH

ON A BALMY FRIDAY NIGHT, THE FIRST REVELERS are trickling into the cool of Bemelmans Bar at The Carlyle hotel on Manhattan's Upper East Side. The Chris Gillespie Trio is getting to work, with Gillespie twisting slightly on his piano bench so he can engage patrons even in the corners of the room. From her perch on a banquette, beverage director and resident mixologist Audrey Saunders grins hello to the regulars while eyeing the orders on the trays her waiters are whisking by.

So far, most guests are playing it safe with wine and sidecars, a traditional brandy and Cointreau cocktail. But once in a while an order comes in for one of Saunders' more inventive intrusions into the classical canon: her Old Cuban, a $17 mojito topped off with Champagne instead of club soda, or her $1. Dreamy Dorini Smoking Martini, which melds vodka with, o all things, one of the smokiest of single-malt scotches.

Saunders, who abandoned a lucrative drape-cleaning business six years ago to practice the art of mixology, does with cocktails what Gillespie does on a keyboard. She keeps the reliable standards fresh with nifty interpolations of the ingredients Only, unlike Gillespie's always-composed trio, Saunders occasionally lets loose—as in the Dorini—with the cocktail equivalent of an ear-splitting screech on the saxophone.

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sy—along with a fanatical devotion to fresh and unusual ingredients—has been crucial to reviving the night life at Bemelmans. The bar is named for children's book author Ludwig Bemelmans, who wrote the *Madeline* series and in 1947 painted the walls with charming renditions of his creations. Following a $2 million renovation of the tobacco-stained room three years ago, Dale DeGroff, the cocktail consultant brought in to devise a new menu of drinks, recommended his young protégée for beverage director. (Long fascinated by drinks, she took his mixology course and then worked with him for free at benefits around the city to learn the craft.)

That has left Saunders, 40, in a highly visible position in what remains very much a man's preserve. She has used Bemelmans as a pulpit from which to preach the fresh-and-inventive gospel she learned from DeGroff, while demonstrating an equal dexterity at designing great drinks and attending to the business of the bar.

What Saunders and her friend and sometime collaborator Julie Reiner of New York's Flatiron Lounge have brought to mixology is a more culinary approach. They pay far greater attention to ingredients and the proportions in which they're combined than traditional bartenders. That's no mean accomplishment in drinks, which too often tend to be thrown together.

Even today, with a cocktail revival in full swing, Saunders laments the trend toward oversweet concoctions made from premixed ingredients. Such drinks erase the character of the liquors and forego the fresh fruits and herbs that should be the joys of a well-constructed cocktail. Vanilla martinis? Not at Bemelmans. Sour mix dispensed from a "gun" behind the bar? Saunders would sooner shoot herself.

Instead, Saunders ransacks such 1940s bibles as David Embury's *The Fine Art of Mixing Drinks* or Charles Baker's *The Gentleman's Companion* to learn how to balance sweet, sour, and strong ingredients, or bittersweet and strong ones. "Once you know the basic ingredients, it's easy to pull out one and put something else in," she says.

BLITHE SPIRITS

FOR A BASE, Saunders most often uses gin, thanks to the range of flavors provided by various brands. She has been among those lobbying to revive long-overlooked rye whiskey, for its powerful spiciness. But she thinks America's most popular spirit, vodka, is overused: "Why would I want to use vodka when there are so many other interesting spirits out there? Vodka's a no-brainer. Put juice with it and you've got a fruit smoothie, not a real cocktail."

Saunders argues it's more important to explore unjustly neglected spirits and aperitifs—names like Chartreuse, Punt e Mes, Fernet Branca Menta, Crème d'Yvette—that elicit blank stares from many bartenders today. Rather than look to the distillers for innovation, Saunders invents her own new tastes by infusing (steeping) into spirits exotic ingredients that might be overwhelmed if simply mixed in—say, Earl Grey Tea for the famous Earl Grey "MarTEAni" she created two years ago for a Thanksgiving celebration at the Ritz Hotel London.

HERE'S TO LIFE Saunders puts a new twist on classics such as the Gin-Gin Mule (right) with ginger beer, and the Booker Manhattan (far right) with bourbon

Visitors to Saunders' apartment describe it as a riot of infusion experiments—coffees, juices, herbs, spices, whatever. "Audrey's a bit of a mad scientist," says DeGroff. Once she has uncovered an interesting flavor combination, Saunders will tinker with it endlessly until the proportions are just right. "Her attention to detail amazes me," says her friend Reiner. "I'll do 15 or 20 versions of a cocktail, but she'll do 100" before settling on the best.

The results can be startling. Saunders' most audacious concoction, the Dream Dorini, is named for a whiskey-drinking friend, Dori. Though martinis had been created using blended scotch whisky instead of vermouth, Saunders went further, using a peaty single-malt whisky called Laphroaig. Its smoky taste would have overwhelmed its companion, Grey Goose vodka, except for Saunders' inspired idea of adding a few drops of Pernod as "the lion tamer." It's not clear why that should work, but it does.

Such virtuosity has convinced the cocktail crowd that the drapes lady is a true original. "Audrey seems able to envisage flavors that will marry well even if they haven't been tried before," says whisky expert Gary Regan, who has a Web site, ardentspirits.com, and was an initial skeptic. While Regan himself has long urged that single malts be used in mixed drinks, "it was the whole recipe that astounded me. As you know, the Libation Goddess was right," he says, calling Saunders by her e-mail handle.

As the first Dorini of the night passes by on a tray, Saunders allows that "it's a bizarre drink, and if you don't like it, that's O.K., too." Even that radical recipe, though, boasts simplicity and balance. "You can create new things, but they have to stem from history. We make them fun and delicious, but we haven't strayed very far," she says. Spoken like both a true revolutionary and a keeper of tradition. ■

The Old Cuban

To create a mojito that could be enjoyed year-round, mixologist Audrey Saunders balances a hefty aged rum and bitters against champagne, adding a split vanilla bean rolled in sugar as a festive garnish.

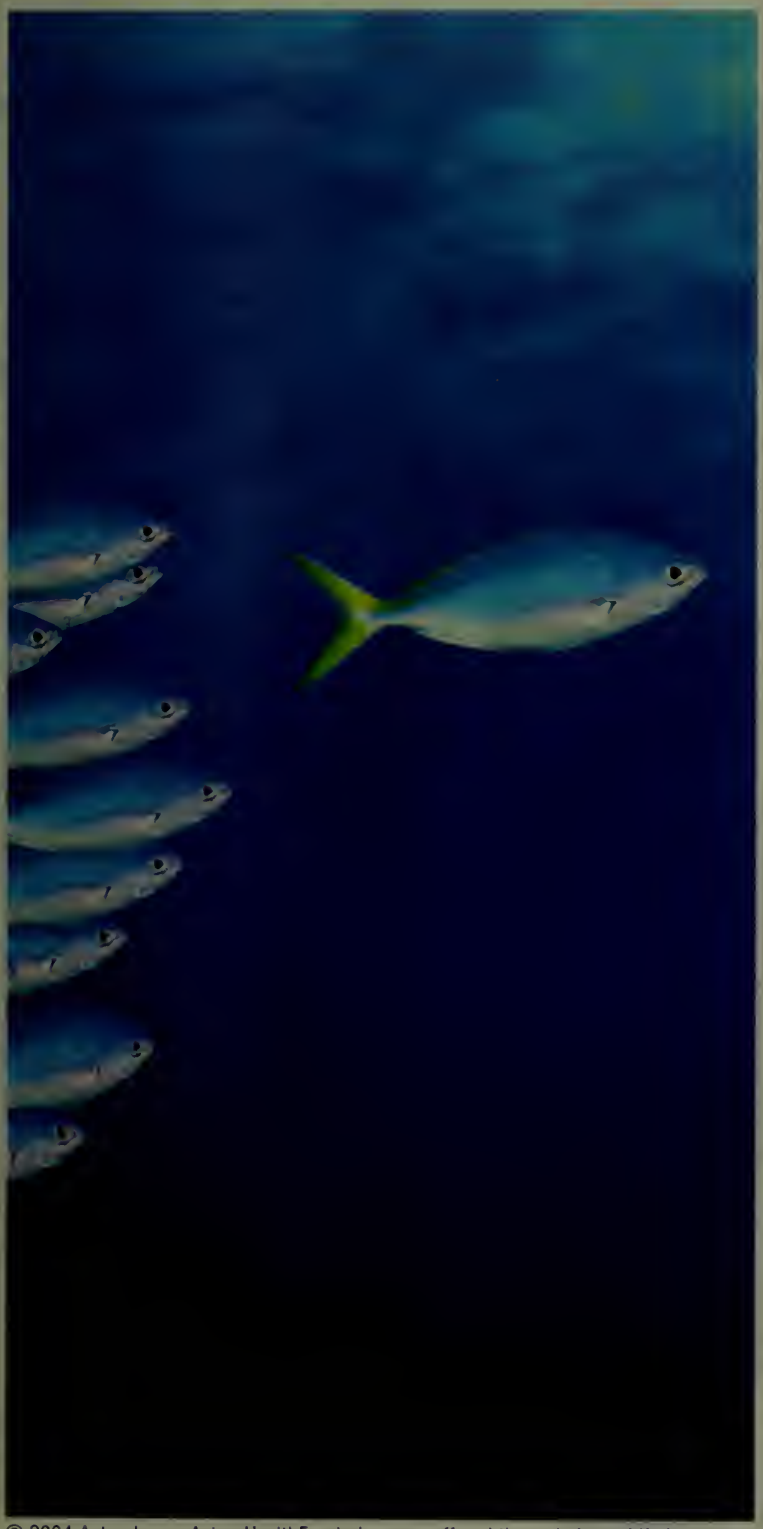
¾ oz. lime juice
1 oz. simple syrup (equal parts sugar and water, uncooked)
2 dashes Angostura bitters
6 mint leaves
1½ oz. Bacardi 8-year-old rum
2 oz. high-quality Champagne

Measure lime juice, simple syrup, mint, and bitters into a mixing glass. Muddle mint to extract flavor. Add rum and ice. Shake all (except Champagne) and strain into a chilled martini glass. Top with Champagne, and garnish with a vanilla bean and floating mint leaves.

BusinessWeek online For more of Audrey Saunders' cocktail recipes, go to www.businessweek.com/execlife

We want you to know

Aetna's Leadership



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Wheels That Do More Than

Cars to

Muscle Car

2005 CHEVROLET CORVETTE We've peeked at the sixth-generation Corvette, due out this fall. It leapfrogs the last generation in every way: The car's 400-hp V-8 bests the old one by 50 hp. The all-new chassis provides a more comfy ride. It rolls on bigger wheels. The interior is classier. Best of all, starting at $43,445, it's a steal compared with European performance cars.

ust Get You Around

Love

Y LARRY
RMSTRONG
ND DAVID
ELCH

COME INTO OUR DREAM GARAGE. HERE YOU'LL FIND OUR favorites from this year's crop—cars we've become attached to, cars we cherish, cars that make us smile. You'll find the right car for every situation: The car to take the edge off of your daily commute. The car for ferrying your kids, their gear, their friends. The car for leisurely weekend jaunts, picnics in the country, trips to the beach. The car that will snag the primo valet spot at that hot nightclub. The car for getting away from it all, solo. Our criteria, like those of most car shoppers, were highly subjective, even emotional. We looked for cars that were fresh and good-looking—and capable of turning heads. They had to be trendsetters, not followers. Then there was the cool factor, a buzz about the car. Fit and finish, and high-quality interiors, were a given. And, of course, they had to be fun to drive. We think our cars will find their way into your heart, too. Maybe even into your garage.

Daily Driver

2004 BMW 545i When it comes to a luxury sedan that's both comfortable and a kick to drive, BMW's 5-Series has long been the benchmark. That hasn't changed with the all-new 545i ($55,000). Sure, the styling's a bit controversial, such as the eyebrow-like turn signals above the headlights. And we'll forgive the techno-excess of the iDrive controller: At least simple climate and audio features now are accessible without it. The car's basics win us over. The 545i's fast and nimble, yet always composed. If you don't need the power of the V-8, the six-cylinder model starts at $39,800.

Dream Cruiser

2004 BENTLEY CONTINENTAL GT When Rolls-Royce and Bentley split up last year, car buffs got to see what direction their new German owners planned for the legendary marques. BMW put forward the Phantom, clearly a Rolls but one with chunky, inelegant styling. Volkswagen offered the Continental GT ($149,000), a sumptuous, sinewy Bentley and the fastest four-seat coupe in the world. The 12-cylinder engine puts out 552 hp, taking the car up to 60 mph in less than five seconds and to a top speed of 198 mph in not much more. The cabin is unapologetically opulent and the price remarkably reasonable for this class of car.

amily Hauler

04 CADILLAC SRX Few midsize luxury SUVs are as sporty and as much fun as the SRX 37,995). Its styling and underpinnings come from Cadillac's CTS performance sedan, king the SRX almost as nimble as a car around corners, yet still cushy and comfortable highways. It's roomy, too: Including a two-person rear bench, which stows in the floor, it seat up to seven. The V-6 version is peppy enough for us; models with the Northstar V-8 are much pricier and really cut fuel economy. Check out the optional rear-seat entertainment center and the UltraView roof, which opens up five square feet of sky at the push of a button. With that, this SUV is practically a convertible.

Weekend Runabout

2005 MINI COOPER CONVERTIBLE As if the Mini weren't fun enough for zipping along and darting in and out of traffic, Mini parent BMW is giving us a ragtop. Now topless, it's a great weekend car for trips to the beach as well. It's cheap, too: The 115-hp Cooper convertible starts at $20,950, the supercharged, 163-hp Cooper S at $24,400. We suggest the S because it's so much quicker and has sportier seats and suspension. There's an aluminum roll bar built into the headrests, and the power roof is one of a kind: You can slide it back 16 inches, like a sunroof, or you can open it up all the way. Enjoy the breeze.

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JULY 2004

SALESFORCE.COM ENTERPRISE EDITION

PC MAGAZINE EDITORS' CHOICE

salesforce.com, which pioneered the model of delivering CRM applications as a hosted service, has pushed its offering even further with its latest refresh. Improved product and price-book management support for publishing solutions in a knowledge base and tools to detect and merge duplicate records are all pluses for an already strong product.

e were particularly impressed with salesforce.com's panded customization capabilities and Sforce Studio, ich lets administrators extend Salesforce's capabilities thout programming.

The hub of any CRM system is customers, and salesforce.com ovides ample means for managing and tracking interactions ith them. You can establish campaigns and track leads gen-ated by campaigns, forms, imported files, or other channels. ou then convert leads into contacts and active accounts when ou've qualified them. Leads can be directed to a particular user into a queue accessible by multiple users.

New in salesforce.com are some minor but helpful touches, ch as the ability to track the roles of different contacts in an ganization and to establish parent/child relationships for mpanies. The service also includes sophisticated capabilities r handling complex pricing structures for different customers, ith support for multiple price books, pricing in different cur-ncies, and pricing based on installment schedules.

We especially liked salesforce.com's new tools for finding nd merging duplicate data, which let us specify on a field-by-eld basis which of up to three conflicting records contained e most current information. And the application's tools don't nd with the sale. salesforce.com includes contract tracking vith workflow capabilities and renewal reminders.

We found that the service's power emerged most clearly vhen we customized our installation. Using Sforce Studio, ve added custom fields to contacts, accounts, and other RM entities. A layout editor with DHTML drag-and-drop upport made reorganizing input forms easy. We were able o create fully customized objects with their own attributes

SALESFORCE.COM'S dashboards give you at-a-glance insight into the key metrics you define for your business.

and relationships to other objects in the system, build forms around these objects, and even add a tab so that our assets behaved almost like native objects, such as leads. None of this required any programming. But if programming is what you want, salesforce.com also exposes its Sforce API and Web services interfaces so you can integrate salesforce.com with other applications.

With salesforce.com's off-line edition, we captured a Briefcase of information for use when disconnected from the Web. The off-line edition uses an interface nearly identical to the one on the live service, except that it contains only accounts, contacts, and opportunities. You update your Briefcase before disconnecting, and when you return, you check back in and resolve any conflicts. This feature isn't as effective as the merge interface used elsewhere in the product, however. But salesforce.com does provide an Office Edition that plugs into Microsoft Outlook, Excel, and Word.

If you're looking for a comprehensive on-demand CRM tool that can streamline your sales and support processes, salesforce.com is an excellent choice.

salesforce.com Enterprise Edition
$125 per user per month. salesforce.com inc., www.salesforce.com.

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Classic Beauties

Collecting Vintage Cars Can Be a Great Ride. Here's How to Avoid the Potholes

BY DAVID WELCH

JOHN McMULLEN REALLY LOVES CARS. THE 76-YEAR-old Michigan car dealer started buying collector automobiles in 1986, when an ad in *Hemmings Motor News* caught his eye: for a two-tone, blue-and-cream, 1932 Packard. He flew to Chicago to inspect the car and plunked down $220,000 for it.

Since then, McMullen has amassed one of the largest and most impressive private collections in the U.S. He owns 130 cars worth $9 million in all. His 275-acre farm north of Detroit houses everything from an 1886 Benz (that's before it was Mercedes-Benz) to '60s muscle cars. He also owns Bette Davis' 1949 Cadillac and a 1931 Duesenberg built for comedian Joe E. Brown and later owned by reclusive billionaire Howard Hughes. Says McMullen: "It's easy to get turned on to it."

True enough. Tooling around town in a well-restored vin tage car makes a statement all its own. Sure, driving a ne Mercedes tells people you have made it. And buzzing dow the street in a Porsche 911 says you are into the sportin lifestyle. But owning a classic is different. It suggests mone but it also puts its owners into a special coterie—those who e ther know how to fix up cars or at least have a discerning ey and can pick a good one. Drive a classic, and it is assumed yo are among the automotive cognoscenti.

Posers beware. If you don't really know old cars, you can ge burned. You need a methodical approach. First, novice collec tors should be careful at auctions, where fees can jack up th price and savvier buyers have an advantage. Second, do you research and examine many cars of the same model befor

ıg. And it's important to seek the advice of experts. "You just go out and buy an old car," says Richard Lentinello, r of *Hemmings Motor News*, which publishes articles t the hobby and lists plenty of collector cars for sale. 'll be sorry."

ıe first thing you should do is decide exactly what car you . Whether you like 1930s hot rods, old Jaguars, or ards, find the make or style and era you want. What you ct will, of course, depend on what you want to spend. classics can sell for over $1 million, but muscle cars the '60s and '70s can be found in good shape for t $20,000.

o to car shows and find the vehicle that catches your eye. ı hit the books. Car magazines and reference works will tell if certain years or models were rarer—and hence more able—than others. If it's a Packard you want, join a local ard club. Memberships cost $20 to $30 a year. Most car s have technical experts who know which cars to avoid and re to get parts and restoration work done.

REFUL SEARCH

B MEMBERS CAN HELP YOU avoid easy mistakes. Here's xample. *Car & Driver* Editor-in-Chief Csaba Csere recently ght a '65 Jaguar E-type convertible. While doing research, iscovered that the Series 1 E-types, which had the car's clas- covered headlamps and chrome-encircled grille, are worth % more than Series 2 E-types, and that convertible E-types the most valuable of all. All told, Csere's E-type es 1 convertible is worth twice what a Series 2 coupe would ıg, assuming they're in the same condition. But someone ing a Series 2 may not volunteer that information.

Once you know what you want to buy, start shopping. *Hem- gs* is a good source for cars, and so is the Web site, Auto- ler.com. Auctions can be good, too. But novice collectors y want to take along someone who knows old cars, says tinello. Auctions charge h buyers and sellers a fee, ually about 8% of the sales ce. Plus, the well-heeled, big- e collectors will sometimes ke high bids to get a car they nt, forcing others to pay more n they might if they found a ilar model elsewhere.

Be prepared to look at a lot of s before buying. Csere says he v 10 Jags before buying his '65 ype. He traveled all over the ntry to find one. "If you're t interested in investing the ne to look, perhaps you ouldn't be buying a collector r," he says.

Seek models that are in good ndition or have been recondi- ned. Even though it may be r cheaper to buy a fixer-upper, the long run it could cost uch more, says Rob Myers, vner of RM Auctions Inc. Sometimes the restoration costs can exceed the car's value. Myers says a '65 Pontiac GTO convertible that has spent its entire life in wintry climes, probably has rusted-out floor panels and other parts, and can cost $100,000 to restore it to showroom condition. The car is worth only about $60,000 in great shape.

Even good-looking cars should get a thorough inspection. McMullen says he once bought a '56 Pontiac hardtop that

» Muscle cars from the '60s and '70s go for about $20,000

looked great. When he got the car home, he found out that the frame was bent. He eventually sold the car at a loss.

Restored cars can be troublesome, too. Car club members can tell you which models are prone to frequent problems. They also know what to look for to make sure you're buying a classic that is worth the price. Some models had limited edition packages with rare engines that can be far more pricey. Rare collector cars are called classics, while other nice old cars are just called collectors.

When you're ready to buy, take a second look at the specific car before reaching for your checkbook. You might spot some problem you didn't see before. Also, it pays to hire a mechanic or an appraiser for a second opinion. Car appraisers, who often act as judges at car shows, grade collector cars on a standard 100-point scale.

Take the car out on a test drive. Make sure that the brakes stop the car evenly and the engine runs smoothly. RM Auctions, for one, allows test drives if you show up early, but many auctions don't. That's one problem with auctions. The other is that you see the cars only on that day. But usually there are plenty of appraisers on-site that you can hire to look a car over.

If it's done right, investing in a collector car can eventually bring a return. Right now, Chrysler cars with vintage Hemi engines are hot, because the company has revived the name and motor for its new models. Myers of RM Auctions says he sold a rare '71 Dodge Hemi Cuda convertible for $250,000 five years ago. It's worth $700,000 today. Chrysler made only seven of them.

Still, most cars aren't great investments. So newcomers to the hobby should buy just ones they like for the pure enjoyment of it. ■

Before You Buy That Collector Automobile...

If you don't really know old cars, you can get burned when you first buy one. So you need a methodical approach:

1. **JOIN A CAR CLUB** It costs only $20 to $30 a year. Find one specific to your favorite make. Look for them on the Internet, at car shows, or in collector-car publications.
2. **SHOP TILL YOU DROP** Collectors say it's smart to look at as many as 10 cars of the same model to get a good feel for pricing.
3. **HIRE AN EXPERT** Car appraisers will inspect a model for a few hundred dollars and tell you if the price is fair and if there may be mechanical problems.
4. **BE FLEXIBLE** Don't get hung up on buying a car of a particular color or model year. Make your choice based on optimum price and the condition of the vehicle.

Porsche Crazy

For Me, the Thrill Is in Souping Up The Basic Car with Go-Fast Parts

BY LEE WALCZAK

MENTION "PORSCHE" TO A CAR NUT ANYWHERE, and the imagination is stirred. Unlike Ferraris and other classic sports cars that look gorgeous from every angle, the Porsche 911 has an egg shape that's an acquired taste. It's both a VW bug on steroids and Germany's pragmatic answer to temperamental glamour cars. A 911 is not so much beautiful as purposeful. The stark interior is no symphony in hand-stitched leather. But the thing is fast. And unlike flashier competitors, it works day in and day out, on jaunts to the dry cleaners or at the racetrack.

I first became aware of the Porsche mystique when I got the sports-car bug back in my youth. I took up rallying in a stylish but mechanically dodgy Triumph TR-4 and began attending road races. Back in the late '60s, Porsches were bathtub-shaped and showed their VW bloodlines. But they flew around the track, and as much as I disliked their styling, I was impressed by their speed and reliability.

A STREET-TRACK HYBRID

BEING A SUCKER FOR a pretty face, I spent years thrashing around in sports-car hell before I wised up. Aside from the aforementioned Triumph, there was a Corvette that rattled and leaked. Next came an Alfa-Romeo GTV-6 that gushed oil and crunched second gear. Even the Japanese invasion offered little solace. My pretty Datsun 240-Z was well bolted together, but it needed better shocks, an aftermarket exhaust, and other add-ons to provide the performance that matched its looks. After I added those things, of course, they broke, and then the Z started to rust.

I finally bought a Porsche in 1987 and have never looked back. I am now a P-car addict and attend regular meetings—weekends at road courses—to commune with my fellow slaves to speed.

The three Porsches I have owned have been solid and reliable, of course. But I discovered that the real joy in these things is modifying the basic car with go-fast parts. Beginning with a '95 Carrera that turned into an all-out racer complete with composite bodywork and a screaming 390-horsepower motor, I went on to convert another 911 into a rare 3.8-liter RS Clubsport. At only 2,650 pounds and with 298 hp on tap, it's perfect for weekend racing—yet it's still street legal.

Lately though, my wife has complained about the uselessness of the RS (race seats, a roll cage, stiff springs, and aluminum bodywork hardly befit a daily driver). I began to wonder if there was another Porsche for slightly [illegible] tional people with day jobs like [illegible] (I'm *BusinessWeek*'s Washington [illegible] reau chief) who want to cut loose [illegible] weekends. I found the answer in [illegible] 996 GT3, a limited-production m[illegible] (base price is $104,000 and only [illegible] will be sold) that's a true street-tr[illegible] hybrid. The GT3 is lighter than a st[illegible] 911, has a beefier suspension [illegible] quicker steering, and sports a 380 [illegible] engine. There's no backseat, no sp[illegible] and a tiny gas tank. On the road the [illegible] still gives a firm but acceptable ride. Folks, this is my kind of [illegible]

I took a GT3 test car out to Summit Point Raceway, a 2 [illegible] mile circuit in West Virginia, and entered a "driver's edu[illegible] tion" event sponsored by the National Auto Sport Assn. NA[illegible] people are a congenial group of enthusiasts that offer driv[illegible] the opportunity to hone their skills on the racetrac[illegible]

BOY RACER Walczak with the best and raciest of the 996 Carrera line

It was a revelation. The GT3 corners flat, the clos[illegible] ratio gears were perfect, and the engine provided tu[illegible] bo-like acceleration. As I rocketed down the fro[illegible] straight at nearly 150 mph, I realized that there was s[illegible] much more that the GT3 could give with a little more familia[illegible] ization and some stickier race tires. Afterwards, I peeled the mag[illegible] netic numbers off the car, packed my race gear, and drove hom[illegible] thinking that life in Porscheland is sweet.

This car—the last and best of a 996 line that will be supplan[illegible] ed by an evolutionary series in 2005—is what Porsche is a[illegible] about. It melds the rational side of your brain with the goofy ado[illegible] lescent side. And it does it in a mechanical package that defies th[illegible] stereotypes about sports-car exotica. ■

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BUT CAN YOU SEE THE FUTURE?

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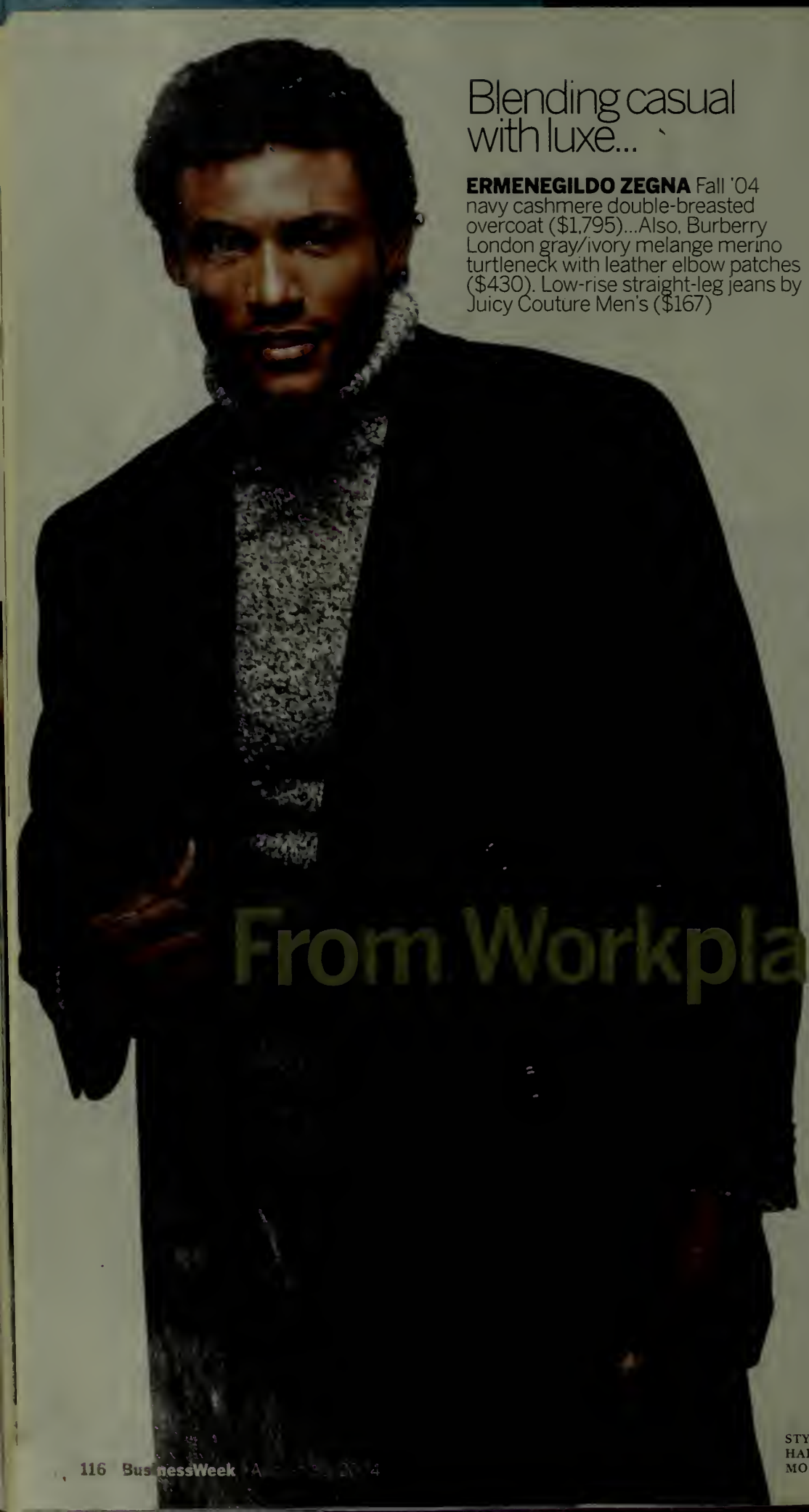

Blending casual with luxe...

ERMENEGILDO ZEGNA Fall '04 navy cashmere double-breasted overcoat ($1,795)...Also, Burberry London gray/ivory melange merino turtleneck with leather elbow patches ($430). Low-rise straight-leg jeans by Juicy Couture Men's ($167)

From Workplace to Ana

St

STYLED BY NAILA RUECHEL
HAIR AND MAKE-UP BY GAVIN ANESBURY
MODELS: RALPH/ELITE; LAURA/Q; JD/FORD

CHRISTINE SUMMERSON

OGRAPHS BY BEN BAKER/REDUX

BUTTON UP YOUR OVERCOAT. When taking care of yourself is the goal, what could be better than luxurious outerwear and great looking sportswear? With emphasis on the casual end of "business al," we've paired some of this season's men's topcoats with our favorite aters and pants. For women, we've fo- d on coats to adore, in beautiful fabrics n tweeds to textured weaves. Many of the men's coats feature belts and bold details n buttons to fringe. The fit: streamlined.

and an about-town feel

RIS women's coat in k and white wool ed with grosgrain snap closure, tie , and fringe trim 990), worn with s black smocked tweight cashmere l silk turtleneck 70)...Also, Club naco black wool flat- t pants ($99)

BURBERRY LONDON "Elsey" car coat in charcoal lambswool reverses to glen plaid ($1,250), and black cotton flat-front pants, ($160)...Also, Loro Piana cashmere classic v-neck in coral melange ($525). Zegna Couture striped tie ($175). White shirt by Kenneth Cole ($59)

ace: The New Fall Look

yle

New fabric processing shields the finest cashmere from wind and rain

)uterwear hat multi-asks

RO PIANA (far) Icer Coat, in tural cord vallery Storm stem 100% cash-ere twill, is wind d waterproof, and s an anti-radiation ield Pocket for cell one ($3,695) Also, Rainforest ollection's oatmeal arter-zip pullover four-ply 100% shmere ($325). ub Monaco brown ol flat-front pants 99). Z Zegna wool riped scarf ($165)

RMENEGILDO EGNA (left) hearling toggle-osure coat in dark own ($4,150), with Zegna brown and d houndstooth ool-mohair rtleneck ($250) Gap relaxed boot-fit ght fade jeans ($58)

MARC JACOBS ight) hooded holeskin field jacket $1,175)...Also, enneth Cole wool-otton sweater in ightfall ($79). Black hirt by Nautica $69.50)

For fall '04 women's coats, it's all in the details

ues of een and own

RC JACOBS (far travel nacaan in bronze ester/ spandex 0)... Also, six-ply % cashmere ded zip-front igan in army n by Armand dourian ($895). na Couture white in herringbone ve with green e ($425). Paper m & Cloth hand-led Low-5-Full-t-New-2-Year s ($182)

UTICA (left) red topcoat in colate ingbone ($298) easy-fit jeans 9.50)...Also, and Diradourian s green two-ply % cashmere k turtleneck vertical stripes 25)

RBERRY ORSUM (right) men's pine green ange wool-mere button-n coat with belt box pleats, front back ($1,470)

Subtle plaids and patterns

MARC JACOBS mini glen-plaid balmacaan in black, brown, and blue, ($1,180)...Also, navy "Lupetto cash light" lightweight 18-gauge cashmere mock turtleneck by Loro Piana ($550). Ermenegildo Zegna brown cotton flat-front pants ($325)

FAÇONNABLE red wool herringbone coat with black button and flap-pocket detail ($595)...Also, Julia Neaman wool plaid mini vent skirt with asymmetrical hem ($195)

» Boxy cuts add a retro dash to overcoats

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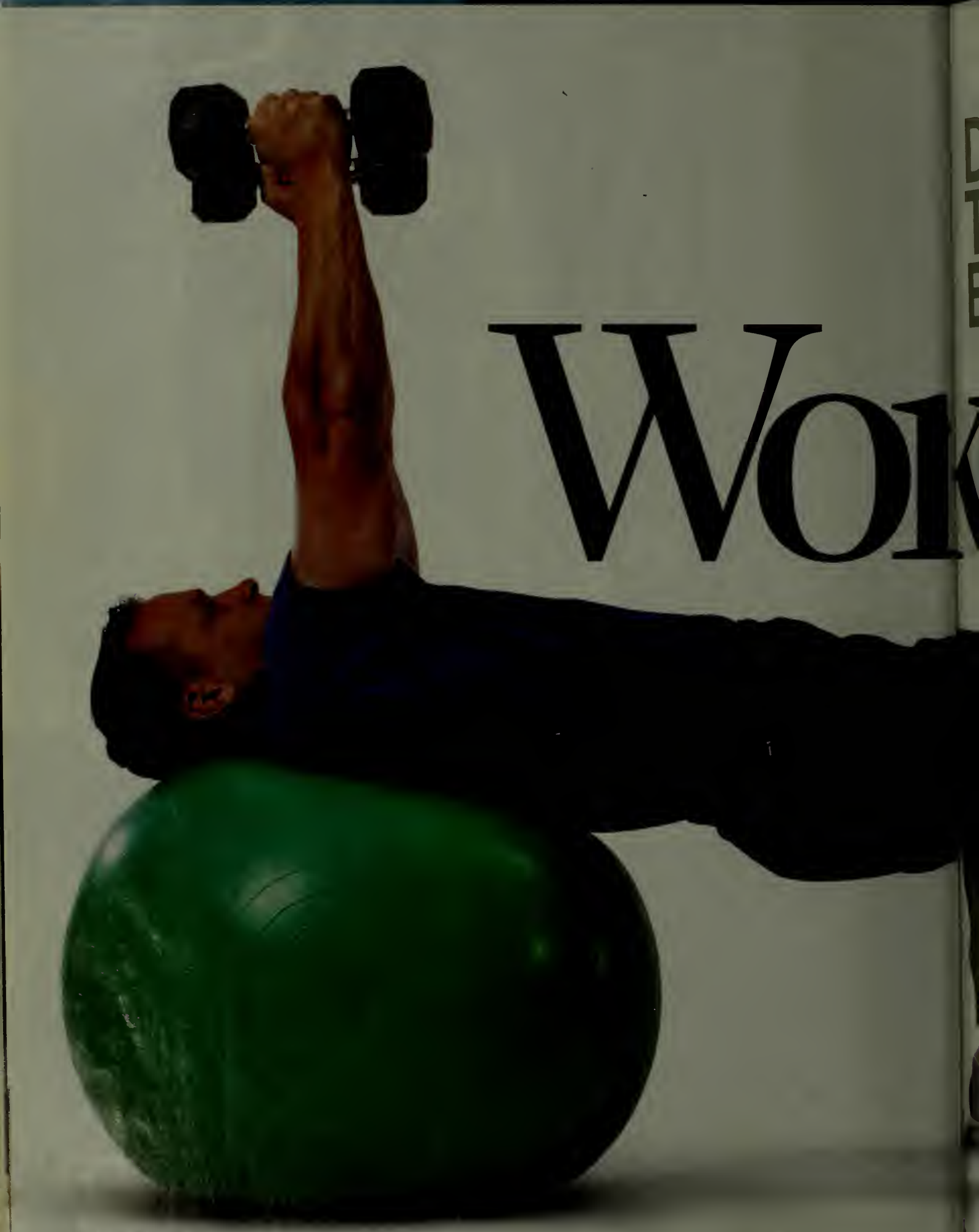
ptember 3, from 5–7 p.m. and Saturday, September 4, from 3–6 p.m.
d on ABC Sports Sunday, September 5, from 5–7 p.m. and
onday, September 6, from 3–6 p.m. (all times E.S.T.)

**roceeds from the Deutsche Bank Championship will benefit
e Tiger Woods Foundation and local area charities.**

A Passion to Perform.

Deutsche Bank



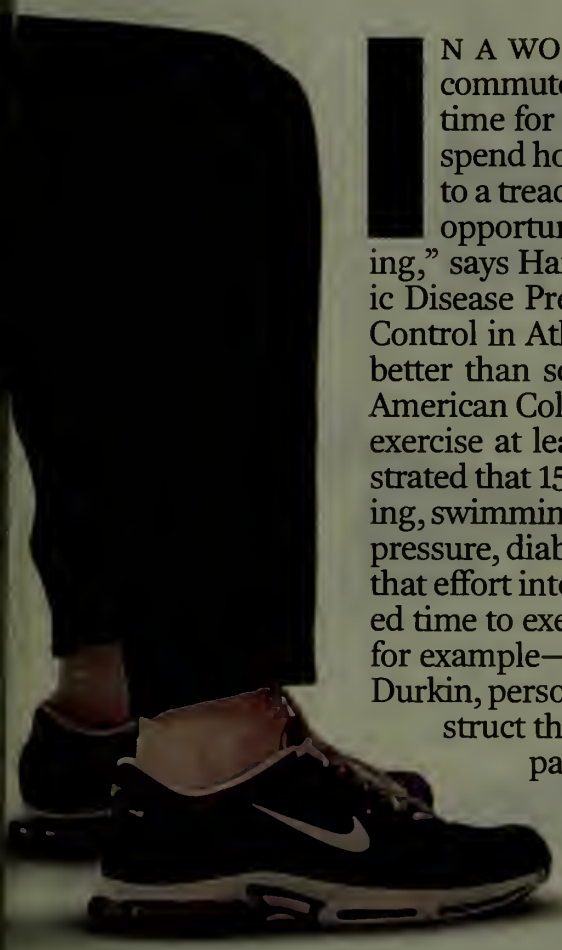
Wo

Does It Seem Impossible To Find the Time to Exercise? Think Again

kout

BY ELLEN LICKING

PHOTOGRAPHS BY STEVE LABADESSA



IN A WORLD WHERE EXECUTIVES FACE LONG DAYS AND TIRING commutes, it's as hard to set aside hours for weekly exercise as it is to find time for family and friends. But for health purposes, you don't need to spend hours at a stretch pumping weights in a gym or tethering yourself to a treadmill. All that's required is to change your mindset and find new opportunities to get your body moving. "Something is better than nothing," says Harold Kohl, an epidemiologist at the National Center for Chronic Disease Prevention & Health Promotion, part of the Centers for Disease Control in Atlanta. At the same time, he concedes that "something more is better than something." That's why, for nearly 10 years, the CDC and the American College of Sports Medicine have urged healthy American adults to exercise at least 30 minutes a day, five days a week. Their studies demonstrated that 150 minutes a week of "moderate intensity" activity—brisk walking, swimming, or cycling—could reduce the risk of heart disease, high blood pressure, diabetes, and bone fractures. Recent research shows you can divide that effort into smaller increments, spread throughout the day. So with limited time to exercise, what kind of workout—cardio, weight training, or yoga, for example—gives the most bang for the buck? *BusinessWeek* enlisted Todd Durkin, personal trainer and owner of Fitness Quest 10 in San Diego, to construct the ideal modular 30-minute workout, featured on the following pages. It uses light weights and exercise balls to build strength, balance, and flexibility—and you can move through the components of the routine whenever you can snatch the time.

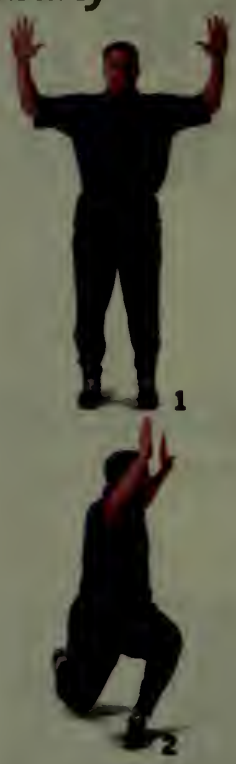
BusinessWeek online For the author's more detailed analysis on exercise routines for busy people, go to www.businessweek.com/execlife

Do It Now

These Exercises Require Few Props and Build Strength, Balance, and Flexibility

1 Walking Lunge and Rotation

Stand up straight, arms extended above head. Step forward with one leg, knee bent to about 90 degrees, and bring back leg almost to the floor. As you step, rotate your trunk and upper body in same direction as the step. Return to neutral position, then step, lunge, and rotate to the opposite side. This works the trunk and legs—specifically quadriceps, hamstrings, and gluteals. Do two sets of 20 to 30 repetitions, keeping front knee in line with your front foot and upper body as erect as possible.



2 Woodchoppers

Stand with your feet shoulder-width apart. Grasp a five-pound dumbbell lengthwise with both hands. Holding it over your right shoulder with your arms as straight as possible, slowly squat, bringing the dumbbell down diagonally on the lower left side. Return to the starting position by rotating your entire body back to the upper right as far as you can comfortably go. This works the trunk and legs. Do two sets of 10 repetitions on each side.

3 Knee Tuck and Push-Up

Kneel behind the ball with your hands resting on it. Roll forward until your thighs are on it an your hands are on the floor in front. Hold your midsection rigid and high off the ground. No slowly bring your knees toward your chest, rollir the ball in as far as it w go. Hold for a second ar release slowly back to starting position. Do a push-up, slowly bendin your elbows to lower your head to the floor. Hold for a second, then go back to the starting position. Repeat this set 10 to 15 times, keeping your head in front of you hands and your trunk rigid at all times.

4 Crunches

Start with your lower back supported on the ball. With arms behind your head, lift your upper body toward the ceiling. To avoid neck strain, exhale on the way up and pretend you're holding an apple under your chin as you complete the exercise. Do two sets of 15 reps. Note: The further back you are on the ball, the more difficult the exercise.

5 Hip Extensions

Start with your head, neck, and upper back completely supported by the ball. Stretch your arms out comfortably to both sides. Slowly lower your hips as close to the floor as possible. Return to starting position, exhaling as you come up. Hold for two seconds while squeezing the hip and gluteal muscles. Keep your knees perpendicular to your body at all times and the ball stationary. Do two sets of 15 reps.

Dumbbell
ench Press

on the exercise ball so
t your head, neck, and
er back are completely
ported. Hold one
nbbell in each hand close
our shoulder. Press the
nbbells toward the
ing, rotating your palms
ard as you come up. Hold
a second, then return to
starting position. Do two
s of 15 reps, keeping hips
h and exhaling on the
ssing part of the motion.

1

2

7 One-Arm Dumbbell Rows

Drop your left leg back about 12 to 16 inches so that it's staggered with your right leg. Place your right hand on the ball, keeping your back flat and parallel to the ground. Hold the dumbbell in your left hand, with your arm fully extended. Pull the dumbbell toward your left hip, elbow facing the ceiling. Retract your left shoulder blade and hold for two seconds, then return to starting position and repeat on the other side. Do two sets of 15 reps on each side.

1

2

1

2

8 John Travoltas

Stand straight up with your feet shoulder-width apart. Holding a light dumbbell in each hand, extend your hands over your head with your elbows bent at 90 degrees. Your palms should be facing away from your body. Pinch both of your shoulder blades together. Move your entire right arm and hand down across your body so that your thumb is touching the left pocket of your pants. Return by rotating your thumb up and lifting your arm back over the right shoulder. Maintain the position with your elbow up and shoulder blade pinched for the duration of the exercise. This is a good workout for shoulders and rotator cuffs, but start with light weights: 2.5 lbs. recommended. Do 10 repetitions consecutively on the right side and then work the left side of the body.

1

2

9 Lying Tricep Extensions

Lie down on the ball so that your head, neck, and upper back are supported. Keep your hips and back extended at all times and your knees at 90 degrees. Holding on to dumbbells, stretch your arms over your head, palms facing inward, and bend your elbows. Keeping your elbows in line with your shoulders at all times, extend your elbows toward the ceiling so the dumbbells finish straight above your head and shoulders. Return to the starting position and repeat. Exhale on the way up, keep your elbows narrow, and do not move the ball. Do two sets of 15 reps.

0 One-Legged Balance
ouch and Bicep Curls

alance on your left leg. With arms straight, hold
dumbbell in each hand. Bend your ankle, knee,
nd hip (1) and lower the two dumbbells straight
own as low as possible (2). Return to starting
osition and transition into the next movement.
ith dumbbells by your side and palms facing in,
owly rotate your hands up to your shoulders as
ou bend your elbows to 90 degrees (3). Hold for
vo seconds and squeeze your biceps. Return to
arting position. Do two sets of 10 reps per leg.

1

2

3

Gym

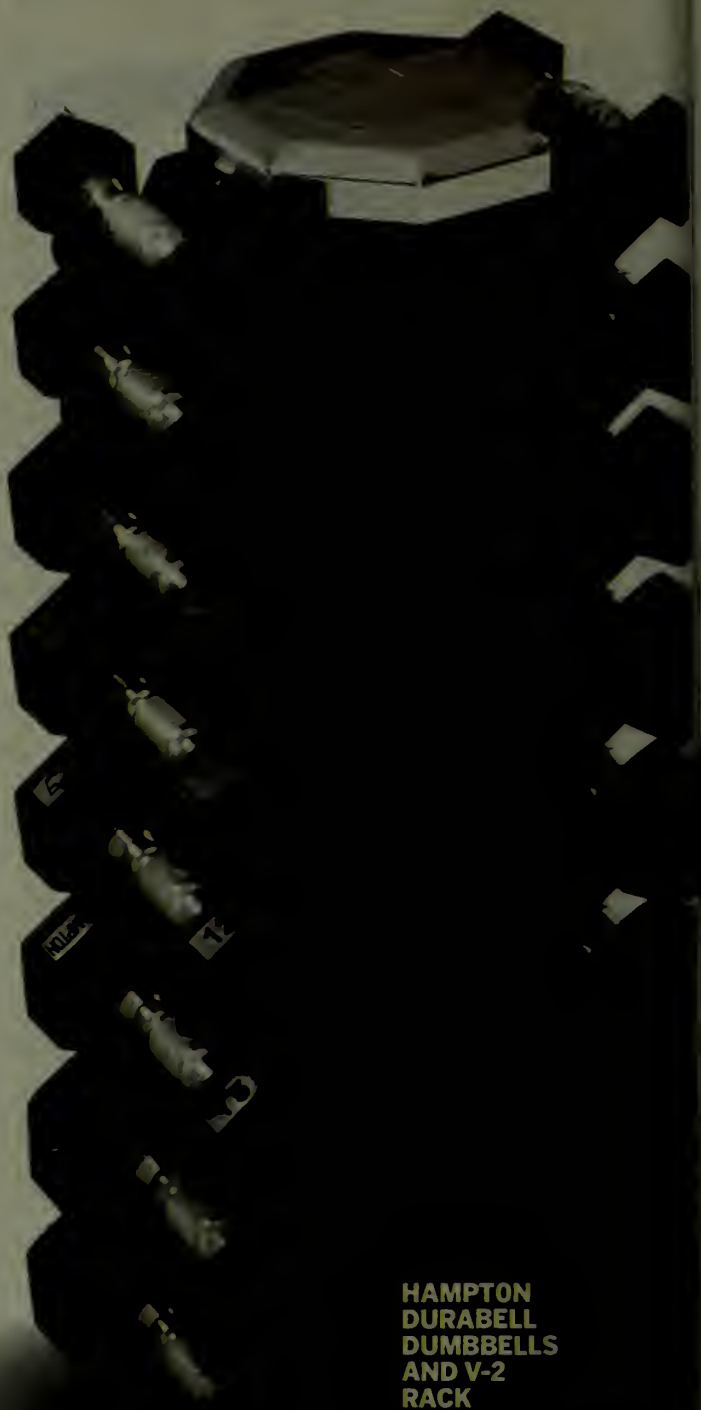
A Home Workout Means No Waiting

BY TODDI GUTNER

BUILDING A HOME GYM ISN'T AS COSTLY AS YOU might think. With as little as $5,500—and about 200 square feet of space—you can outfit your home with the necessary pieces of equipment and accessories to get a health-club-quality workout. Better yet, your club is always open, and there's no waiting.

You'll want to include at least one, maybe two, machines that concentrate on a cardiovascular workout, weights for strength training, and accessories to improve your flexibility. Be sure to try out each machine before you buy it. Ask for discounts when you purchase multiple pieces. Make sure your equipment has a warranty for at least three years and try to buy from a dealer that has its own service department. That will make it easier to get your equipment fixed if it breaks.

It's critical to design the space and plan where each machine will go prior to purchasing it, says Richard Miller, chief executive of Gym Source in Manhattan. "The best way to make sure you use your home gym is to design a room that you want to be in," says Miller. Many dealers offer a design service free of charge. Other things to consider include flooring, lighting, and mirrors. Install carpet or rubber padding to absorb vibrations, and use fluorescent lighting, which gives off less heat. Mirrors can ensure proper form during workouts.



HAMPTON DURABELL DUMBBELLS AND V-2 RACK
$640

Bosu Ball

This half-moon-shaped accessory is made from wood and rubber and filled with air. It is used mainly to help you improve balance. A chart of designated exercises shows how to work it—mostly to strengthen weak ankles and foot-arches.

BOSU BALL
$130

Dumbbells and Rack

Weights should be covered with rubber or urethane to prevent flaking, rusting, and injury. Make sure you have a wide range of weights, up to at least 25 pounds in 5-pound increments, to work different body parts. Dumbbells start at about $1.25 a pound.

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The 2004 Honda Clearance

clearance.honda.com

Multi-Gym

» All multi-gyms should have at least the following four stations (but some will have more): high pulley, low pulley, press station, and leg extension leg curl. To ensure stability, machine should be made from 11- or 12-gauge steel.These machines cost between $1,500 and $2,500.

UNIVERSAL 2000 HOME GYM
$2,495

Treadmill

» Look for a machine with a flexible and shock-absorbent running surface. The belt should be at least 20 inches wide and 54 inches long. Buy a machine that weighs at least 200 pounds so it won't rock when you run. A treadmill with features like a heart-rate monitor, time, and automatic programs will start at $2,000.

TRUE 540HRC
$3,895

Exercise Mat

» Use an air-filled mat to alleviate pressure on the lower back when doing stomach exercises. Foam mats tend to wear down to the ground. The mat should have a rubber-type surface so it doesn't slip. These mats run about $30 to $70.

AEROMAT R58
$59

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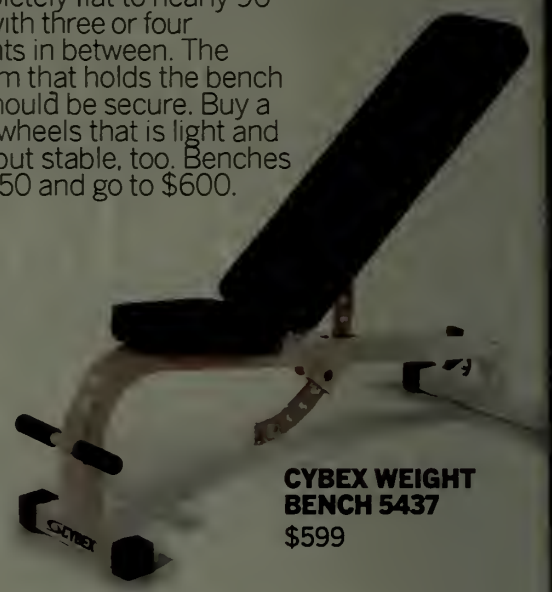
STRETCH BALL
$30

Weight Bench

» The bench should go from completely flat to nearly 90 degrees, with three or four adjustments in between. The mechanism that holds the bench in place should be secure. Buy a bench on wheels that is light and movable, but stable, too. Benches start at $150 and go to $600.



CYBEX WEIGHT BENCH 5437
$599

Stretch Balls

» These balls, which run between $20 and $40, are great for stretching and exercising stomach and back. Be mindful of the ball size. They go from 45 cm in diameter to 75 cm in 10 cm increments. Have a small and big ball to use depending on the exercise.

Recumbent Bike

» Most stationary bikes change resistance in 25-watt increments. (Wattage is a measure of resistance, and the higher the wattage, the greater the resistance.) Look for a bike that goes in 5-watt increments, which will allow you to get the resistance level almost to zero. This will minimize effort and injury. These bikes start at about $1,000.

CYBEX SIGMA RECUMBENT BIKE
$3,195

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ENDURANCE Green has worked out with Haviland for 15 years

Trainers

There's a Trick to Finding the Right One. It's Like Choosing a Doctor

BY TODDI GUTNER

SUFFERING WITH ELBOW TENDONITIS AND RECOVERING from a dislocated shoulder, Richard Green was beginning to feel old and run-down at 37. He wanted to get back to something like the excellent physical shape he enjoyed in high school and college, when he played football and lacrosse. So he decided to hire a personal trainer.

Green was lucky. Because he followed some simple guidelines, Green chose a trainer with whom he could form a lasting and productive relationship. Now, 15 years later, Green, 52 and the president and CEO of Firstrust Bank in Philadelphia, still exercises with his trainer, John Haviland, at 6 a.m. four mornings a week. "I don't know if my workout adds more years to my life, but I do know that it adds more life to my years," says Green.

Hiring the right trainer takes some sweat. To do it right, you should undergo the same "effort you would when you choose a doctor or a lawyer," says Mike Niederpruem, national director for certification at the American College of Sports Medicine (ACSM). These tips can help:

MAKE SURE THE TRAINER'S EXPERIENCE MATCHES YOUR GOALS Green knew he wanted a trainer who would be sensitive to sports injuries. Green chose Haviland, in p because Havil had also pla football in coll and had suffe shoulder injur Haviland's physical therapy train was critical. Green credits Havil with saving him from shoulder gery, recommending cortisone sh for his elbow, and rehabilitatin broken hand. "He helps me end the nicks and bruises of modern li says Green.

GET A MOTIVATOR The ability "connect with your trainer and h compatible personalities" is very important, says Kathie Da executive director of IDEA Health Fitness Assn. Request a trial wo out, or at least try to observe t trainer in a session or two with a other client. "A good trainer sho be able to get you to identify a commit to your goals, but not eve one can do that," says Davis. Ha land makes sure that Green's wo outs are varied so that he does n get bored.

REQUIRE FITNESS ASSESSMEN Every client should have a fitne screening before going ahead w the initial workout. The trainer needs to ask you specific que tions about medical conditions, the medications you may be u ing, your aches and pains, and previous injuries and surgery it relates to exercise. Green knew from the friend who refer Haviland that he provided continuing fitness assessments a would keep track of Green's workouts and chart his progress

CHECK THE CERTIFICATIONS Ideal you want a trainer with certificatio from at least one of the international recognized organizations (table). Hav land has certification from the America Council on Exercise. Ask whether t trainer is certified in first aid and ca diopulmonary resuscitation. It's also in perative that the trainer have at least $ million in liability coverage.

CALL REFERENCES Because Green g Haviland's name from a friend, he had good idea of how the trainer worked wi clients. But in other cases, when you get referral from a health club, doctor, or ce tification Web site, you'll also want to g feedback about the trainer from someon who works with him or her. If you' lucky, you could forge a long-term rel tionship like Green's. He has been wi his trainer almost as long as he has bee with his wife. ■

So You Want to Hire a Pro?

Ideally, you want a trainer with certification from at least one of the internationally recognized organizations. Most sites allow you to search for a trainer in your area.

American College of Sports Medicine	acsm.org
American Council on Exercise	acefitness.org
National Academy of Sports Medicine	nasm.org
National Strength & Conditioning Assn.	nsca-lift.org

Data: BusinessWeek

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d where prohibited by law. Three (3) two-day apprenticeship prize packages will be awarded. First Prize: two days with the Boston Celtics; Second Prize: two days
a California vintner; Third Prize: two days working on a Broadway show. Each prize includes air and ground transportation to the hotel, lodging, and $500 spending money. Average retail value of each prize is $3,500. Entries must be submitted by 5:00 PM (EDT), September 6, 2004.

OM ALONE Enhancing the qualities companies need in their human capital

Meditation

New Research Shows That It Changes the Brain in Ways That Alleviate Stress

BY MICHELLE CONLIN

IN 1999 A HARVARD UNIVERSITY MAGNA CUM LAUDE named Kaleil Isaza Tuzman quit his job as a French-cuffed arbitrageur at Goldman Sachs to found a startup called govWorks with his childhood best friend, an experience that was captured in the riveting documentary *Startup.com*. As the company unwinds, we see the once-smooth Tuzman kick furniture, burn through girlfriends (not to mention $60 million), and, in the company's last gasps, send a two-sentence letter of termination to the best friend—all before he was 30.

What we don't see, however, is that Tuzman had let his long-time meditation practice slide. When he was at Goldman, Tuzman often closed his eyes on the trading floor to meditate—a Zen man in Zegna. But when he plunged into govWorks and its 20-hour days, he slacked off. "I have regretted letting it lag f years," says Tuzman. "Because if I had stayed disciplined, have a feeling I would have been able to see some of the ha bingers and perils that I didn't see at the time." Today, Tuzma now CEO of Recognition Group, is back at his 20-minute-a-da practice, sometimes shutting his office door and sitting balle dancer straight in his leather swivel chair.

For decades, researchers at the National Institutes Health, the University of Massachusetts, and the Mind/Boc Medical Institute at Harvard University have sought to doc ment how meditation enhances the qualities companies need i their human capital: sharpened intuition, steely concentratio and plummeting stress levels. What's different today groundbreaking research showing that when people such a

man meditate, they alter the biochemistry of their brains. e evolution of powerful mind-monitoring technologies has enabled scientists to scan the minds of meditators on a miscopic scale, revealing fascinating insights about the plasty of the mind and meditation's ability to sculpt it.

Some of those insights have emerged in the lab of Richard vidson, a professor of psychology and psychiatry at the Unisity of Wisconsin at Madison. Throughout his career, Davidn has pondered why people react so differently to the same essful situations, and for the past 20 years he has been conting experiments to find out. With the blessing of the Dalai

CEO meditators say it has made hem more effective

ma, who is supporting U.S. neuroscientists in their quest to ck the mysteries of meditation, Davidson has been placing ctrodes on meditating Buddhist monks as they sit on his lab or watching different visual stimuli—including disturbing ages of war—flash on a screen. Davidson and his team then serve the monks as they meditate while ensconced in the nking, coffin-like tubes of MRI machines.

What the researchers see are brains unlike any they have obved elsewhere. The monks' left prontal cortexes—the area associated th positive emotion—are far more ace than in nonmeditators' brains. In her words, he says, the monks' medition practice, which changes their ural physiology, enables them to reond with equanimity to sources of ress. Meditation doesn't lobotomize editators; it simply allows them to dech from their emotional reactions so ey can respond appropriately.

"In our country, people are very inlved in the physical-fitness craze, rking out several times a week," says avidson. "But we don't pay that kind attention to our minds. Modern neuscience is showing that our minds are plastic as our bodies. Meditation can elp you train your mind in the same ay exercise can train your body."

Davidson's research didn't stop with e monks. To find out whether meditaon could have lasting, beneficial effects the workplace, he performed a study Madison (Wis.) biotech company romega. Four dozen employees met nce a week for eight weeks to practice indfulness meditation for three hours. he result, published last year in the urnal *Psychosomatic Medicine*, showed at the employees' left prefontal cortexes were enlarged, just like those of the monks. "We took typical, middle-class Americans trying to cope with the demands of an active work life and active family life who reported being relatively stressed out," says Davidson. "And what we found out is that after a short time meditating, meditation had profound effects not just on how they felt but on their brains and bodies."

These results matter at a time when companies lose an estimated $200 billion annually in absenteeism, subpar performance, tardiness, and workers' compensation claims related to stress. In fact, stress-related ailments account for upwards of 60% of all doctor visits, according to the Mind/Body Medical Institute. President Herbert Benson, an associate professor at Harvard Medical School, notes that stress does amp up performance to a certain level. But sustained too long, it erodes productivity. "If businesses were clever, what they would do is simply put time aside [and have] a quiet room for people to carry out a meditative behavior of their choice," says Benson.

Some are already doing so. AOL, Raytheon, Nortel Networks, and even ultra-staid law firm Cleary, Gottlieb, Steen & Hamilton offer their employees meditation classes. At some companies, the practice gets advocacy from the top. Medtronic's former CEO, Bill George, who has meditated twice a day for 20 minutes for the past 30 years, says: "Out of anything, it has had the greatest impact on my career." (Life offers many opportunities: George meditates from the time his plane taxis to when the steward offers him a Diet Coke.)

Former Aetna International Chairman Michael Stephen also started meditating in 1974 and says it helped transform him from an impatient, demanding know-it-all into a more effective leader. Ex-Monsanto CEO Robert Shapiro is such a devotee that he brought in teachers to help his execs learn the practice. And McKinsey Managing Partner Michael Rennie, an avid meditator, has studied the beneficial effects of meditation in corporations.

Health insurers are starting to realize that meditation, like preventive health and exercise programs, may help them control costs. Cigna is so intrigued with the new meditation findings that it has hired Davidson's partner, Jon Kabat-Zinn, founder of the Stress Reduction Clinic at the University of Massachusetts Medical School, to study the ways in which meditation may be able to reduce costs for everything from chronic fatigue to irritable bowel syndrome.

Of course, as with exercise, it's natural to face difficulties adhering to a schedule or to go through periods when you question the payoff. That's why it's important to find a teacher, a Zen center, or some other authority to turn to in such moments, much as one turns to a personal trainer to help maintain or heighten the challenge of an exercise regimen.

The point is: Don't just do something—sit there. ■

Getting Started

It's best to work with a teacher, but if you want to go it alone, here are the basics: Find a quiet place, sit in a comfortable position with your back straight, and observe your breathing for 10 minutes or more.

1 **MINDFULNESS MEDITATION** Focus on your breathing, and when your mind starts to stray, gently bring it back.

2 **INSIGHT MEDITATION** Follow the sensations in your body and notice how they change.

3 **ZEN KOAN MEDITATION** Ponder questions that can't be answered with logic, such as: "What is my true self?" This helps you detach from everyday thoughts.

4 **CENTERING PRAYER** Choose a simple word that has meaning for you, such as "love," "compassion," or the Sanskrit mantra "om," and repeat it over and over, either silently or aloud, quieting all other thoughts.

Data: Mirabai Bush, executive director of the Center for Contemplative Mind in Society

The Executive Life Health

How to Weigh the Competing Claims of All Those Weight-Loss Plans

Diets

Y CATHERINE
RNST

IF YOU ARE THINKING ABOUT A DIET, YOU ARE PROBABLY PONDERing which side to choose in that huge divide splitting America—low carb, or low fat. The fact is, it doesn't matter. Take "The Zone," a low-carb diet developed by Dr. Barry Sears. He calls for all meals to follow a 40-30-30 distribution—40% from carbs, 30% from protein, and 30% from fat. The formula lends gravitas, but it's not why you lose weight. If The Zone's initial meal plans and portions are followed exactly, you are eating 850 to 1,000 calories a day. Considering that the average daily calorie intake for adult Americans is 2,750 (that's 500 more than the government recommends, by the way), it would be almost impossible not to lose weight. ¶ Diets come and go. But we keep forgetting that there is only one way to successfully shed pounds: Burn off more calories than you take in. This is an ironclad law of bodily thermodynamics. Diets that claim you can eat as much as you want of certain foods and still slim down make it sound

TAXI/GETTY IMAGES

as if you'll never go hungry again. It's just not going to happen. The reason: It doesn't matter how your calories are ingested, only how many.

A calorie, which is a unit of heat, is the same whether it's contained in a slice of bread, a slab of steak, or a stalk of celery. There are 3,500 calories in a pound of body fat, so to lose a pound per week you have to burn off 500 calories per day more than you take in. On average, women need 10 to 11 calories per pound per day to remain at their current weight, and men need 12 to 14. Multiply your desired weight and your current weight by those numbers, subtract the difference, and you'll know how many calories you should cut.

Counting calories, however, is complex. Weight-loss expert Dr. Donald D. Hensrud of the Mayo Clinic in Rochester, Minn., says this is why diets fail. "People on diets consistently underestimate their calorie intake."

Consequently, most of the best-selling diet books throw calorie-counting out the window. Instead, they advocate sticking to certain food groups while eliminating or reducing others. That can be an easy way to cut calories, especially if you've been loading up on the carbohydrates, fats, or sugars that are banned. It is almost inevitable that if you cut out all carbs, for example, you will lose weight, because you are eating less food.

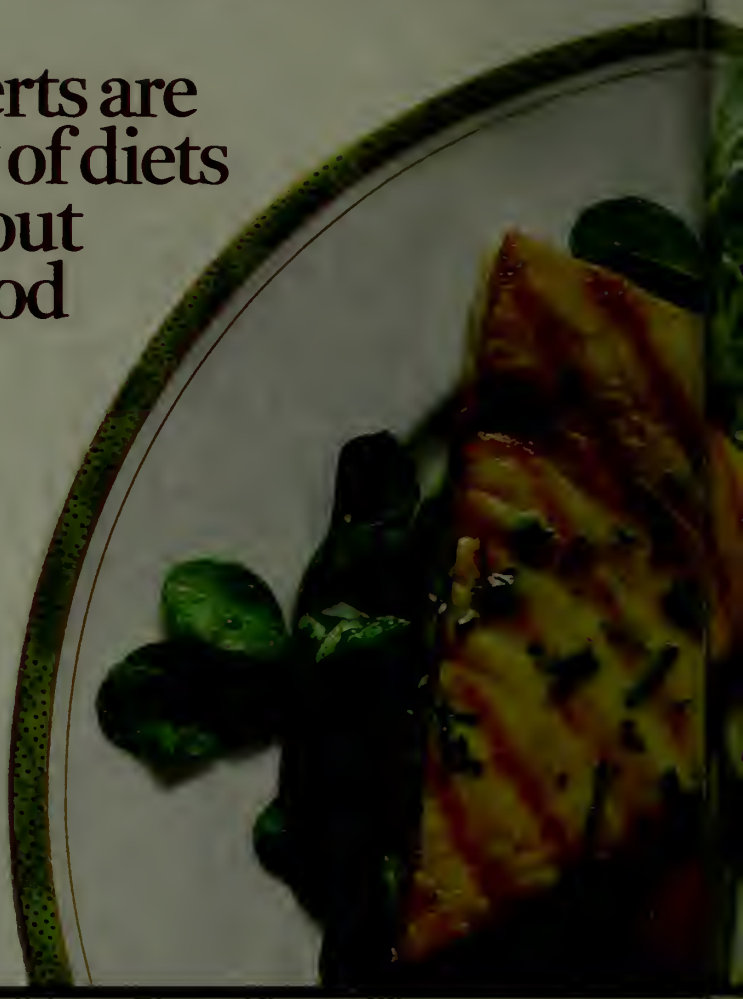
Many medical experts aren't wild about weight-loss plans based on food restrictions. A well-balanced diet combined with portion control is widely considered more healthful than one that eliminates certain foods. It can also be very hard to stick to a diet over the long term that cuts out entire food groups, and the long term is what matters. Studies have found that up to 95% of all dieters regain lost weight after a year—and even add more pounds.

Still, food-restriction diets are enormously popular. They can be easy to follow and often produce immediate results. What's hard is wading through the competing claims from the many different plans. Each has its fervent adherents, and carries both pros and cons.

Low-carb diets are the current craze, led by the Atkins and South Beach diets. Fast-acting carbs such as refined flour, p ta, and white rice quickly break down into glucose (sugar) m ecules in the blood, which in turn unleash a surge of insul High insulin levels can stimulate hunger, and low-carb adv cates argue that you will eat less if you minimize insulin surg Several studies have shown that this strategy is very effective the first six months, but by the one-year mark, even Atkins r searchers have found that the low-carb diets have just as hi a failure rate as other weight-loss plans.

Medical specialists also worry about the long-term heal

Experts are leery of diets that cut out entire food groups



Choosing to Lose There's only one way to drop weight—cut calories

	ATKINS	THE SOUTH BEACH DIET	Dr. Sears ZONE
RATIONALE	**Strict limits on carbs; high in fat and protein.**	**Another low-carb diet, restricts foods with "high glycemic index."**	**A strict ratio of carbs to protein to fat w insulin levels in peak "zone" for promo weight loss and maintaining energy.**
PROS	Can initially lead to very rapid weight loss; easy to follow.	Less restrictive than Atkins, so can be easier to stick with; allows more whole grains, fruits, and vegetables than Atkins.	Balanced diet and very low calorie intake lead to rapid weight loss; though high in protein, it does call for lots of fruits and vegetables.
CONS	Concerns are mounting that a high-protein diet may damage long-term health; not for anyone with diabetes, kidney, or heart disease.	Health associations recommend against using glycemic index for weight loss; concerns about long-term health.	Little evidence that insulin levels can be manipulated as claimed; low calorie inta leave you hungry.

act. The Partnership for Essential Nutrition, a coalition of lic-health groups that includes the American Obesity Assn. Shape Up America!, recently did a survey of the scientific ature on low-carb diets. It concluded that these diets can l to kidney stress, liver disorders, and gout and can increase risk of heart disease, diabetes, and stroke.

On the other side are the low-fat advocates, such as the Pri- n Principle and Weight Watchers. This approach has been ular for well over a decade, as evidenced by the huge rease in low-fat foods displayed on supermarket shelves.

The medical Establishment particularly favors low-fat diets for their proven ability to help prevent heart disease. Also note that the National Weight Control Registry, which has collected data on more than 3,000 people who maintained a loss of 30 pounds or more for at least one year, found that the majority of successful dieters in the registry followed a low-fat program.

Keep in mind, though, that successful dieters are few and far between. It's tough to cut fat without feeling hungry all the time, and many people end up replacing fat calories with carb or sugar calories. Besides, some fats, such as nuts and olive oil, can be good for you.

Ultimately, the successful diet is the one that works for you. Figure out your current eating habits and lifestyle, and decide what changes you are most likely to stick with. If you are seriously overweight or have a health problem, a consultation with a doctor or a dietician is the best way to start. Then incorporate these rules, which apply to any weight-loss program:

- Exercise. Even moderate exercise, such as a brisk walk three times a week, can make a big difference. Diet alone can take the pounds off, but exercise is the best way to maintain weight loss.
- Eat "low-density" food. Fruits, vegetables, and whole grains have the fewest calories per ounce of any food, so filling up on them can quickly cut calories.
- Eat slowly. It can take 15 minutes for the message to reach the brain that your stomach is full. Don't try to beat that clock.
- Don't get hung up on reaching an "ideal weight." The Mayo Clinic's Hensrud warns that "weight goals can be elusive, and people are rarely satisfied when they reach them." Instead, focus on losing 10% of your weight. Once you have accomplished that, you may be inspired to keep going.
- Avoid crash diets. The most successful weight-loss programs are gradual, usually a pound a week. Rapid weight loss can damage your health, and it's rarely sustainable.

Finally, don't think in terms of diet—it's such a depressing word—but lifestyle change. Remember, there was probably a time when you never supersized anything. Get back to that, and weight loss should follow. ■

BusinessWeek online For an interview with Barbara J. Moore, President and CEO of Shape Up America!, a national initiative to promote health, please visit www.businessweek.com/execlife

are many ways to cut them.

eightWatchers	PRITIKIN	Jenny Craig
ed diet, with emphasis on portion dieters follow a point system for foods.	**Cuts calorie density with low-fat, high-fiber foods, combined with exercise. Eliminates almost all processed food.**	**An individualized, low-fat approach; eat their foods and work with their counselors.**
nced diet combined with weekly s provide lots of support from fellow designed for long-term weight loss.	Designed for heart-disease patients, this is one of the most healthful diets. There is no calorie counting or portion control.	The one-on-one approach is a very effective way to ensure compliance.
tem can be complicated. Don't expect ight loss.	Almost a vegetarian diet, it can be hard to stick with; requires a lifestyle overhaul. Low in calcium.	It's expensive and can be complicated.

PHOTOGRAPH BY DENNIS M. GOTTLIEB/CORBIS

Checkup Checklist

Monitoring Becomes More Important as the Years Pile Up. What Counts Is Spotting Trouble Early

WITH EXOTIC GENE-BASED diagnostics and advanced imaging, you can test for plenty of diseases. But should you? Most experts are against full-body MRIs, which pick up minuscule abnormalities that probably won't cause trouble. Instead, they recommend knowing your risk factors—diseases in the family, lifestyle choices such as smoking, and environmental exposures—and screening accordingly. Beyond that, the important thing is to pay attention to these common tests:

Body Measurement

Height, weight, waist measurement, and body-mass index

Why? To determine if you're overweight

When? Every two years after age 20

Blood Pressure

Measures the amount of pressure the heart generates when beating (systolic) and at rest (diastolic)

Why? Detects hypertension

When? At least every two years after age 20

Skin exam

Doctor looks for irregular moles

Why? Suspicious lesions can signal skin cancer

When? Should always be part of a regular checkup

Cholesterol Test

Blood test that measures "bad" and "good" cholesterol levels

Why? High cholesterol can raise the risk of heart attack

When? Starting at age 45, every five years

C-Reactive Protein

Blood test to detect levels of CRP, produced by the liver in response to injury or infection

Why? High CRP levels can indicate cardiovascular disease and can be a better predictor than high cholesterol levels

When? Necessary only in the presence of known risk factors for heart disease

Blood-Sugar Test

Measures the level of glucose in the blood after an eight-hour fast

Why? Screens for diabetes

When? Every three years, starting at age 45

Colonoscopy

Various tests examine the colon

Why? To detect cancer and growths that may become cancerous

When? Every 5 to 10 years, starting at age 50, depending on doctor's recommendation

Electrocardiogram

Electrodes read the heart's electrical impulses

Why? Can detect heart conditions such as irregular rhythm

When? If you are at high risk of heart disease

FOR WOMEN

Pap Test

Cervix cells removed with cotton swab and inspec

Why? To detect cancer of the cervix

When? Every three years

Mammogram

An X-ray of the breast tissue

Why? Detects lumps that could be cancerous

When? Every two years, starting at age 50

FOR MEN

Prostate Cancer Screening

A digital rectal exam and/or a blood test for prostate-specific antigen (PSA)

Why? To check for prostate enlargement or cancer

When? Should be considered at age 50

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TOYOTA

Vitamins

You Can Get Most of What You Need by Eating Right. Beyond That, Be Cautious

BY JOHN CAREY

BACK WHEN HUMANS WERE HUNTERS, ALL THAT mattered was getting enough to eat. But the whole nutrition game has changed. Now, instead of trying to bag a mastodon, we're standing in front of crowded shelves trying to choose among bottles of chromium, vitamin C, and zinc. Multivitamins ought to make this task easier, but there's still much confusion. Should you take one aimed at "active" people or dieters? How much vitamin A should a multivitamin contain? What about folic acid?

These aren't simple questions, in part because everyone's diet is different. Some of us get all the vitamins and other "micronutrients" we need from the foods we eat, while others fall short on vitamin D, potassium, and more.

The picture gets even murkier because the science behind nutrition is so inconclusive. Adding micronutrients may help protect against disease, yet high doses of some vitamins can be dangerous. "These are extremely potent molecules," warns Dr. Cutberto Garza, professor of nutrition science at Cornell University. "In their absence we don't survive, but we have no experience consuming [them] in quantities higher than what's found in food."

That's why the safest advice is to eat right. Strive for up to nine servings of fruit and vegetables each day, along with ample amounts of whole grains and nuts. (A serving may mean just a few celery sticks, peach, two-thirds of a cup of juice, or two tablespoons of pean butter.) "We know that increased consumption of fruits an vegetables is protective against cardiovascular disease and a of cancer," says Agriculture Dept. nutritionist Ronald L. Prio

To be safe, add a multivitamin product containing the re ommended daily allowances (RDA) of most micronutrients an minerals. Such products aren't heavily regulated by the Food Drug Administration. But in contrast to many herbal suppl ments from small companies, where consumers can't be su what they're getting, vitamin products from major manufa turers probably do contain what the label claims. The vitami and minerals don't vary much by manufacturer, but produc may be targeted. Men need less iron, about 8 milligrams a da Pregnant women need the most: 27 mg. Women also nee more calcium, and the elderly need more B vitamins.

In general, experts say, taking a multivitamin is safer than co suming just a few vitamins and minerals. "Overloading the sy tem with one vitamin may make things worse other areas," explains Bernadette Latson, a pr gram director at Texas Southwestern Medical Cen ter at Dallas. Some studies suggest that too muc B-6 can cause nerve damage, excess D can caus kidney problems, and excess A could lead to a sle

What For, and How Much?

POTASSIUM Vital for cells; can help control blood pressure. Need at least 2 g/day. Sources include fruits and vegetables.

BORON May help keep bones healthy. Data are insufficient to set recommended levels, but stay well under 20 mg/day.

COPPER Helps prevent h disease. RDA of 900 mic grams/day may be low. C from chocolate, oysters,

oubles. "There are some serious dangers," warns Dr. Sidney Wolfe, director of Public Citizen's Health Research Group. o complicate things, many scientists believe that popping a multivitamin isn't sufficient. For one thing, says Dr. Godfrey akley Jr., visiting professor of epidemiology at Emory Univer- "we know that if we tell people to eat right, almost no one will t." Even if your diet is good, many studies suggest that doses me micronutrients higher than the RDA can be beneficial. ake the B-vitamin family, which includes B-6, B-12, and acid. "It's anybody's guess if some of the things we attrib- to normal aging—such as declining mental function or poor nory—are due to that, or to deficiencies in some of the B vi- ins," explains Latson. Higher levels of B vitamins can low- lood levels of homocysteine, which in turn has been linked eart disease. And the Centers for Disease Control & Pre- tion recommends that every woman who might become gnant take 400 micrograms a day of folic acid (found in ts, spinach, lentils, and other foods) to prevent birth defects.

ECLINING BIRTH DEFECTS

EED, PUBLIC-HEALTH OFFICIALS were alarmed enough ut folic acid deficiencies in the late 1990s that they required r to be enriched with the vitamin. As a result, the number of ural tube" birth defects has declined. So too, have deaths from rt attacks and strokes, says Emory's Oakley. He's convinced t higher levels of fortification, or taking more supplements, uld make many of us healthier. However, "there may be trade- ," warns Cornell's Garza: Consuming higher levels may stim- te tumor growth in individuals or cause other adverse effects. Lately much attention has focused on vitamin D. Humans duce plenty of it in their own skin—but only by being out in sun for at least 15 minutes a day. "The general population s not realize that if you're not getting enough sun, you have to e supplements," says University of Michigan pharmacologist bert U. Simpson. The vitamin is vital for preventing rickets l bone disorders. But Simpson and other researchers have dis- ered vitamin D receptors in the heart and other tissues, sug- ting a cardiovascular benefit. Simpson himself takes 800 in-

Vitamin D may help keep your heart strong

ternational units (IU) of vitamin D a day during winter. Nutritionists say it's time to rethink the official recommendations. "There is a great deal of enthusiasm for enhancing the amount of vitamin D," says John Erdman of the University of Illinois and chair of the Institute of Medicine's standing committee for evaluation of "dietary reference intakes."

In other cases, scientists don't know enough to set a recommended daily allowance. One example: chromium. The average American every day gets 20 to 35 micrograms of this element, which is found at low levels in some fruits and vegetables, such as broccoli. That's not nearly enough, believes Agriculture Dept. nutritionist Richard Anderson. Because chromium makes insulin more effective, higher levels of the mineral can help prevent or control diabetes. The same with cardiovascular disease, says Anderson. He recommends a diet with more complex carbohydrates. "As insurance, you should take [a supplement of] 200 to 250 micrograms of chromium per day," he suggests.

Some of the doctors' recommendations are controversial, and almost none of them is definitive. What to do when even the experts disagree? The first priority is to strive for a better diet. If you add supplements, don't take levels more than a few times the RDA. For maximum safety, stay well below the upper levels—the highest amounts thought to cause no harm—estimated by the committees that make the recommendations. You can find links to all these levels, as well as to the full reports explaining dietary reference intakes, at www.nal.usda.gov/fnic/etext/000105.html. For most essential substances, aiming for 100% of the RDA should assure good nutrition—and peace of mind. ■

BusinessWeek online For an interview with Edward Saltzman at Tufts University's nutrition institute about the benefits and risks of vitamins, please visit www.businessweek.com/execlife

SIUM Helps maintain , bone. Adults need at 0 mg/day but can get m an ounce of almonds.

CALCIUM Builds bones; may help control weight and blood pressure. Many people don't get enough. Found in dairy products.

VITAMIN B Family of micronutrients that may help prevent heart disease, stroke, and neurological problems

IRON Deficiency is common, causing anemia. Pregnant women need the most, 27 mg/day. Adult men need 8 mg.

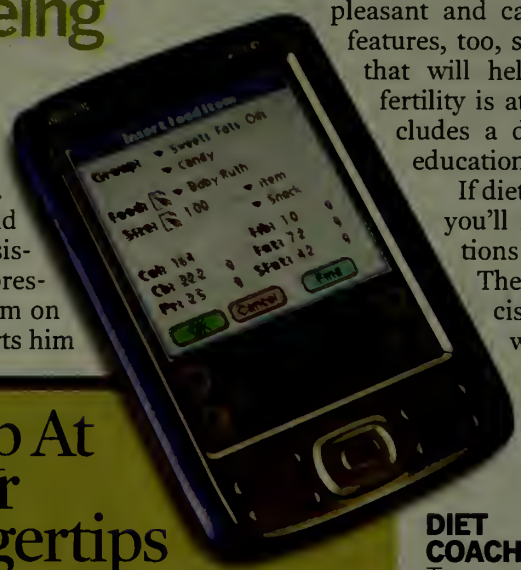
PDAs

The Latest Palms Have Enough Memory to Help Manage Your Well-Being

BY ARLENE WEINTRAUB

RICHARD MILLER HAS ALWAYS STRUGGLED to control his high blood pressure. So last year he turned his Palm handheld computer into a miniature medical assistant. Twice a day, he takes his blood pressure, then taps the results into a software program on his Palm called UTS Blood Pressure. The PDA alerts him when his pressure spirals too high. And it generates detailed charts that allow him to spot trends, such as which activities spark dangerous peaks. Miller can e-mail the info right to his doctor or transfer it to his PC and print it out. "It gives my doctor a good indication of what's going on when he's not around to check on me," says the 60-year-old Miller, who lives in Fresno, Calif.

As handheld computers grow more powerful, they're becoming vital partners for managing your most valuable asset: your health. Today's Palms, Pocket PCs—and even some cell phones—are packed with enough memory to store your entire family's medical history. Advanced features such as Bluetooth wireless messaging and the ability to transport data into PC-based spreadsheets and other applications make it that much easier to maintain your health. Whether you're grappling with a serious medical problem, expecting a baby, or simply counting carbs, you're likely to find a program to help. And you can download the software in seconds from such Web sites as palmsource.com, handango.com, and pocketPC.com.



Help At Your Fingertips

Your PDA can help you count carbs, keep fit, and much more.

RECORD KEEPER Today's memory-packed PDAs can easily store your entire family's medical history, and track medications and other vitals.

CARB COUNTER It can monitor your daily calorie and carb intake, and then coach you toward your weight-loss goal.

PERSONAL TRAINER It will also manage your workout routine, and even coach you through yoga postures.

FAMILY MATTERS

IF KEEPING TRACK of your family's medical history is your greatest challenge, HealthFile may help. This comprehensive program allows you to stay abreast of each family member's vaccinations, medications, illnesses, and surgeries. You can also keep track of weight, blood pressure, and glucose levels. Enter doctors' appointments into HealthFile, and they'll automatically appear on your PDA's master calendar. HealthFile also provides one convenient place to store all the information you can never seem to find when your doctor asks for it, from insurance policy numbers to details of your family disease history.

For those who are preparing to welcome a new family member, Heybaby is a nifty pregnancy aid. Just enter your due date, and each day your PDA will update you on the stage your baby is most likely passing through and provide tips to foster his or her development. For example, around your 26th week, Heybaby informs you that your child can probably hear sounds through the womb and that "a little soft music will be pleasant and calming." There are interactive features, too, such as an ovulation calculator that will help you determine when your fertility is at a peak. The software also includes a dictionary of baby names and educational material.

If diet and exercise are your passion, you'll find hundreds of PDA applications to help you achieve your goal. The gold standard is Diet & Exercise Assistant. Enter your height, weight, and weight-loss goal, and each day your handheld will tell you how close you are to reaching it based on your diet-and-exercise routine. You can tap in the foods you eat at each meal, and the program will automatically give you a count on calories, carbs, protein, and fats. Then it will tell you if you did enough bench presses or ran far enough to burn it all off. Diet & Exercise Assistant is so comprehensive that it tallies up stats on some foods down to the brand. It warns you, for example, that a cup of Skittles is loaded with 185.8 grams of carbs, while a Baby Ruth Bar has a mere 22 grams.

DIET COACH Tap your way to weight loss

A good companion program—especially for fitness fanatics—is Personal Trainer PDA. It allows you to build a personalized workout routine and track your progress daily. This isn't just about on-screen stopwatches and other features that help you monitor timed exercises. If you work with a personal trainer who has the same software on a handheld or a PC, he or she can beam your workout instructions directly to your handheld.

Feeling stressed? Yoga might help—with your PDA acting as teacher. The Yoga for Health program provides step-by-step instructions for the postures that make up this increasingly popular form of exercise. Spelling and grammar mistakes aside, it's a very entertaining program. There's even an animated model who pops up on the screen to demonstrate.

Each pose includes a full description of its therapeutic benefits. For example, the Bridge, explains Yoga for Health, "aids in easing and stimulating the mind" (both at once, no less). The particular program may tie you up in knots. But over all, the PDA's growing medical applications should help smooth out the wrinkles in your health and fitness routines. ■

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CHOICES A range of treatments is now available for reducing symptoms

Menopause

What Every Woman–And Man–Needs to Know

BY NAOMI FREUNDLICH

BEFORE THE 20TH CENTURY, MOST WOMEN didn't live long enough to experience menopause. Today, the average woman may live one-third of her life after the onset. Each year, 1.3 million American women enter menopause, and for many, this phase of life is marred by years of hot flashes, mood swings, and insomnia. It's not just the women who suffer: Spouses and children share the distress. Doctors still have questions about what causes these symptoms and why menopause seems to be linked with greater risks of heart disease and some cancers.

Options for treatment have lowed a strange course. Since mid-1960s, millions of women h used hormone replacement ther (HRT) to ease symptoms. In 1990s, several studies sugges that HRT could help prevent h attacks, osteoporosis, colon can and even Alzheimer's disease. was believed to be almost malpr tice to not offer women estrogen menopause," says Dr. Isaac Sc chief of gynecology at Massachu General Hospital in Boston.

Then in July, 2002, the pendul swung. Results from the Wom Health Initiative, a large, eight-y study funded by the National In tutes of Health, found that HRT di prevent heart disease or breast ca cer—in fact, it raised the risk sligh Estrogen is still a standard treatm for hot flashes and mood disord But now many doctors try to indi ualize treatment with a variety of f mulations in pills, patches, o creams. Some also recommend al native therapies. Here is what ev middle-aged woman and her fam need to know about menopause:

When does it begin?

Menopause actually happens three phases. The first, called pe menopause, can last for two to ei years as the ovaries gradually d crease estrogen production. At th time women may have irregul menstrual periods, hot flashes, nig sweats, and some mood swings. A tual menopause begins after woman's periods have stopped for consecutive months. The avera age for that is 51, but some wom are affected in their early 40s. The nal phase, called postmenopaus refers to the 25 or so years that m women live after their periods sto

What are the quality-of-life issues and long-term health risks?

Hot flashes are the most common symptom, affecting up to 75 of perimenopausal and recently menopausal women. One-thi of them report more than 10 hot flashes a day. Sleep disruptio mood disturbance, and memory problems are other comm complaints, along with vaginal dryness, headaches, and hea palpitations. About a third of all menopausal women have e ther mild or no symptoms, a third have moderate ones, and f another third, they're serious. Some 25% of women contin experiencing them for 10 years or more.

When estrogen levels drop, the rate of bone loss accelerat

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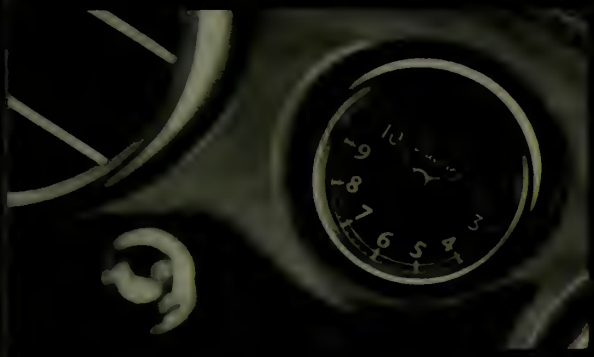

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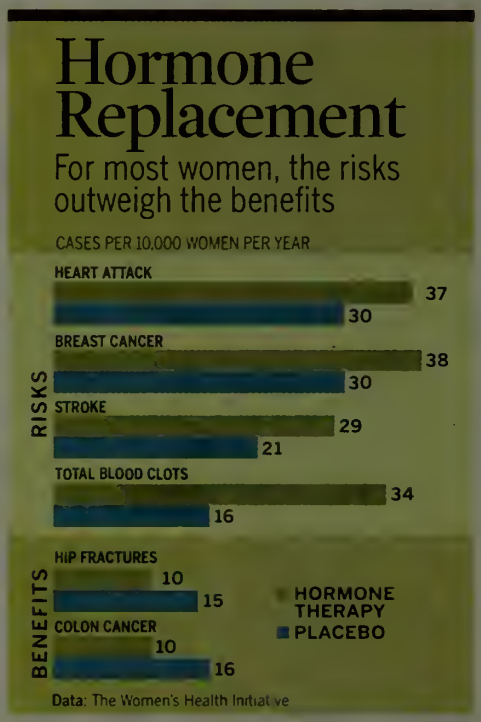
rapidly. The average woman loses 2% to 3% of bone mass a year for the first three years after menopause. As a result, osteoporosis is much more common in the decades after menopause. A woman's risk of heart disease also increases sharply after menopause, but estrogen's role is still under study.

What are the lessons from the Women's Health Initiative study?
It was conducted mainly to learn if HRT could prevent heart disease. It involved 16,600 women—average age 63—who were taking Prempro, a combination of estrogen and progestin made by Wyeth. Although the study was supposed to have run for eight years, it was halted early, in 2002, because the risk of breast cancer appeared to exceed any benefits of HRT. In fact, in the population studied, HRT carried a small but significant risk of breast cancer, heart attack, stroke, and blood clots. Results from another part of the study showed no benefit from HRT in preventing Alzheimer's or other memory loss, and it did not improve the quality of life in postmenopausal women.

The study did find that HRT helped lessen the risk of hip fractures and colon cancer.

How should we interpret these results?
The study is important because it challenged the practice of prescribing estrogen for all menopausal women—symptomatic or not. As for risks, especially for osteoporosis, there are effective alternatives. The point to take home: If you are not suffering from serious hot flashes, insomnia, or debilitating mood disorders, you shouldn't consider HRT.

The study was limited to older, postmenopausal women who were given HRT mainly as a preventative and who took it for 10 or more years. But the average age of women seeking HRT in a clinical practice is 45 to 55, says Dr. Wulf H. Utian, a gynecologist at the Cleveland Clinic and head of the North American Menopause Society. Experts suspect that risks are far less for younger women actively going through menopause who use HRT in the short term to help deal with symptoms like hot flashes. The risks of breast cancer and heart disease in the WHI study, for example, didn't become apparent until hormones were used for an average 5.2 years. That risk was not overwhelming—increasing from 30 cases per 10,000 women to 38 cases.



So HRT is still a valid option?
About 28% of women age 50 to 74 are on it. That's because, despite the WHI findings, nothing seems to works better. The consensus among doctors is that short-term HRT is probably safe for healthy menopausal women who take the lowest effective dose to ease symptoms. The idea, says Utian, is to try to discontinue treatment after two years to see if symptoms have subsided. Ultimately, women should aim to limit HRT use to five years, and women with a history of breast cancer, blood clots, or liver disease should avoid it entirely.

What other drugs can treat menopause symptoms?
Evidence from studies on women with breast cancer found that antidepressants such as Effexor and Paxil can help reduce hot flashes by 50% or more in a majority of patients. But these co with their own set of side effects—such as decreased libido sleep disruption—and some women have trouble getting them. Clonidine, a blood pressure medicine, is also someti prescribed for hot flashes. Used in patch form, it can red symptoms by up to 50%, but at the most effective dose it also cause dizziness and fatigue.

Spicy foods and alcohol seem to aggravate hot flashes

What about osteoporosis?
Raloxifene—known by its trade name, Evista—is one of a n class of drugs called selective estrogen receptor modulat (SERMs) that are approved for the p vention of osteoporosis in p menopausal women. Evista and sim drugs raise the risk of blood clots, women who are prone to them—and need special insurance against osteopo sis—should consider other nonhormo drugs such as Fosamax.

Can certain diets and exercise help?
There's no evidence that they can co pletely replace drugs for women who e perience symptoms. But no one disput that a healthy lifestyle is important, es cially for preventing osteoporosis. maintain bone density, women over age should get 1,200 milligrams of calcium p day and 400 international units of vitam D from food, supplements, or both.

Salty foods can deplete calcium, perts warn. Spicy foods, caffeine, and cohol seem to aggravate hot flashes some women. Exercise, on the oth hand, can relieve them, while improvi bone density. What's most effective a so-called weight-bearing exercises—anything that requir your feet and legs to carry your body weight—such as wal ing, jogging, and dancing.

How do natural remedies stack up?
It's a mixed picture. Literally hundreds of products are sold supermarkets, health food stores, and pharmacies claiming relieve menopause symptoms. Most contain phytoestroger weak forms of estrogen derived from plants, which have son of the same problems as estrogen. None of these products h been shown definitively to reduce hot flashes or build bone, sa the American College of Obstetricians and Gynecologists. So beans and black cohosh have a better track record. Herb creams containing progesterone may help with hot flashes, b since they are not regulated by the FDA, it's hard to know wh you're getting.

For the future, watch developments with SERMs, whic could ease symptoms of menopause and protect bone and hea health without adding to the risk of breast cancer. ■

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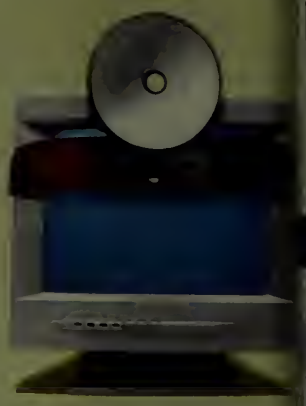
The Best Medical Web Sites



The Net is awash in medical information. The hard part is finding advice you can trust. Some sites display symbols indicating that they are committed to quality standards set by organizations such as the Utilization Review Accreditation Commission (URAC) or Health on the Net Foundation (HON). But the acronyms don't tell you everything. HON sites are largely self-policing, for example. And some good, smaller sites can't afford the more thorough URAC accreditation. What's more, many sites have vested interests—sponsorship by clinics specializing in a particular treatment, say, or by drugmakers whose products are recommended on the site. To learn more, always click the "about us" tab, and make sure the articles were written or vetted by medical professionals. While you're at it, check to see when the information was last updated. Such caveats aside, there is much credible health information on the Net. Here are some sites worth adding to your "favorites" list. *–Carol Marie Cropper*

WEB SITE/SPONSOR	HIGHLIGHTS	QUIBBLES
WWW.NLM.NIH.GOV National Library of Medicine, part of the government's National Institutes of Health	Home to health sites such as Medline Plus, a patient-friendly location for looking up drugs and medical conditions. Gives the latest health news and a link for info on clinical trials in your area. Check out MEDLINE/PubMed, where you can research citations and summaries of articles in medical journals.	Getting the full text of an article cited on MEDLINE/PubMed can be a chore.
WWW.NIMH.NIH.GOV National Institute of Mental Health, part of the National Institutes of Health	Comprehensive and authoritative source of information on mental disorders and treatments. Posts breaking news and information about clinical trials.	After the initial screens, this mostly text site lacks color and razzle-dazzle.
WWW.4WOMAN.GOV U.S. Health & Human Services Dept.	Well-organized info on everything from breast-feeding to menopause, as well as news about women's health. Many reports on the site are available in Spanish.	Bland compared with chatty but less authoritative women's sites.
WWW.MAYOCLINIC.COM Mayo Foundation for Medical Education & Research, an affiliate of Mayo Clinic of Rochester, Minn.	Comprehensive site guides patients who are weighing treatment options. Tools let you calculate everything from body mass index to pregnancy due date. Doctors at the Mayo Clinic and Mayo Medical School contribute to and review articles, except those on drugs, herbs, and supplements, which are licensed from outside sources.	None.
WWW.NATIONALHEALTHCOUNCIL.ORG A nonprofit made up of voluntary health agencies, professional associations, and medical nonprofits and businesses	One-stop directory of links to groups like the American Cancer Society, the American Heart Assn., and the National Hospice & Palliative Care Organization. The council serves as a lobbying/advocacy organization for health agencies, with positions posted clearly on the site.	Contains little original content.
WWW.YOURDISEASERISK.HARVARD.EDU Harvard Center for Cancer Prevention, at the Harvard School of Public Health	Readers can fill out online questionnaires for a quick assessment of their risk for diabetes, heart disease, osteoporosis, stroke, and various cancers. The site ranks your risk. It also throws in tips on lowering risk and praise for what the user is doing right.	There's no posting date on individual articles, although the entire site was updated in June.
WWW.DRUGDIGEST.ORG Express Scripts, a major pharmacy-benefits manager	Allows users to check for potential interactions between the drugs they use, as well as with food and alcohol. Also lets users compare side effects of different drugs. Site tells whether a generic is available, provides a picture of the pill, and cites uses for the medication.	Though it tracks 5,000 drugs, over-the-counter meds, and supplements, it's not all-inclusive.
WWW.QUESTDIAGNOSTICS.COM Quest Diagnostics, a leading diagnostics-testing company	Its health library offers information on medical tests, medications, support groups, and general health topics. There's also a list of frequently ordered tests where you can find out how a test is performed and its risks.	None.
WWW.ONCOLINK.COM Abramson Cancer Center of the University of Pennsylvania	Its library provides physician summaries of the journal articles that have influenced the standard of care for various types of cancer, as well as free access to the table of contents and abstracts from many cancer-related journals. There are also reviews of books and videos for cancer patients, recent news, and accessible background info on cancer and treatment options.	The clinical trials link refers patients only to trials at the University of Pennsylvania cancer center.

BusinessWeek online For more information on useful medical Web sites, go to www.businessweek.com/execlife

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How to Make the Most Of a Makeover—and Boost Your Morale, Too

Remodel

BY PETER COY

WHEN IT COMES TO MAJOR REMODELING, EVERYBODY HAS an opinion about where you should put your money and how much you can expect to get back on it. Kitchen renovations always pay for themselves! No, it's bathrooms! No, family rooms! ¶ Unfortunately, most rules of thumb for fixing up your house aren't worth a pound of sawdust. First, well-intended articles about which projects to undertake are poor guides because different houses have different shortfalls. The person who knows best what your own house needs is you, perhaps with the advice of a well-plugged-in real estate agent and an architect. Second, contractors and other interested parties often overstate how much you'll get back from what you spend. Most studies show that very few remodeling projects add as much to the value of a house as they cost. So don't spend on an elaborate renovation with the idea that it's as good as putting money in stocks and bonds, which

STEPHEN SWINTEK

(in the long run, anyway) tend to have a positive return on investment.

Before plans are drawn up, you need to answer two questions: What does your house really need? Equally important, what do you need? If you plan to sell soon, stick to small improvements that fix glaring flaws. If you hope to stay put for many years, you can indulge yourself with more idiosyncratic projects that appeal to you regardless of whether they add to resale value. For many clients, "remodeling is a really strange mix of a business deal with personal and family emotions tied to it," says David Duncan of Needham Duncan Architecture in Madison, Conn., which specializes in residential and light commercial projects. He says the more you can clarify ahead of time what you want to do and why, the better your chance of success.

DARK? CUT DOWN A TREE

IF RESALE VALUE CONCERNS you, the first step before remodeling is to call in a trusted real estate agent who can tell you what buyers in your area are looking for and where your house matches up poorly against the competition. For example, adding a bedroom isn't always a good choice—but it might be if your house has fewer bedrooms than others in the neighborhood. If you plan to move soon, most agents will advise you to focus on making your house bright, airy, and uncluttered while repairing anything that's broken or leaking. Stick with low-budget projects that will have broad appeal, like fresh paint in light, neutral colors. Anat Eisenberg, a real estate agent in Tenafly, N.J., recommends tearing out wall-to-wall carpeting if you have hardwood floors beneath and painting the exterior in a light color. "It's a visual distortion," says Eisenberg. "People will perceive the house as larger."

If you're staying longer, raise your sights. An architect may point you toward a solution you hadn't thought of. Too often, says Louis Wasserman, an architect with Louis Wasserman & Associates in Milwaukee, "people have a problem and they don't quite know how to solve it, so they solve it by adding space onto space that didn't work to begin with." Inste moving a wall might help traffic circulation at little cost. Sor fixes are even easier. Says Wasserman: "If the living room dark, maybe you just need to cut down a tree."

At the other extreme, if a house's flaws are obvious and s rious, you might be better off selling it as is or tearing it do and starting over. Sinking a lot of money into an unwort

Cashing In

Your House May Still Offer the Best Way to Raise Money

Looking to add a wing to your house, buy a weekend getaway, or pay for Junior's education? Borrowing against your home is still one of the cheapest ways to raise the cash.

REFINANCING

You've probably already refinanced, but it may make sense to do it again. If you have a $500,000 mortgage at 7%, for example, you can lower the monthly payment by $503—or 15%—by refinancing at today's average 30-year fixed mortgage rate of 5.45%. If you can take a chance on a loan that floats after five years, you can go as low as 4.45%. The savings from refinancing has to outweigh the closing costs on your new loan. So if you face $10,000 in costs and can save $503 a month, it'll take you 20 months to break even.

Another way to raise cash is to take a larger mortgage than the one you're paying off. With a $500,000 mortgage on a $750,0 property, you can raise $100,000 by increasing loan to $600,000. Ther limits, though. The mor gage-interest tax deduc is only available on up t million of principal usec buy or improve a home (This, like most itemize deductions, phases out married taxpayers with adjusted gross income above $142,700.)

HOME EQUITY LOANS

Interest rates average 6 for a $75,000 loan. The

L IT One
floor won't
hat much
e total cost

Respect your home's character. on't be a 'remuddler'

se is like putting lipstick on a pig. You're not going to fool ers. "A lot of older homes are on beautiful sites where the e is really in the land," says Margaret Muir, a realtor with e-Taft Real Estate in Madison, Conn., who has worked Duncan. "Sometimes owners work against themselves. y try to make a house into something it was never meant e."

emember as you plan your remodeling that most house ers are walking around with a mental checklist of must-es. If your house is missing even one item from the list, it s being disqualified from consideration. So if you want to vert a fourth bedroom into a den or study, make sure the t owner can easily make it a bedroom again. Remember anything you add that isn't on the buyer's checklist—even ething attractive like a solarium—won't be highly valued.

So if resale is a primary concern, stick to the basics. At best, a unique home will stay on the market longer until the rare family that shares your taste comes along. At worst it will fetch a lower price than a more conventional home.

KEEP UP WITH THE JONESES

HOW MUCH SHOULD YOU SPEND on the big items, kitchens and bathrooms? Enough to keep up with the Joneses but not much more. In other words, if everyone else on the street has granite countertops, then you should, too. But don't go for the gigantic professional stove if you never cook and nobody else on your street has one. Likewise for bathrooms. Adding a bathroom boosts you into a higher tier of properties in the minds of those homebuyers with checklists. But there's no need to make it fancy, says Doug Aleshire, a home designer at All-Pro Home Services in Royal Oak, Mich. For example, says Aleshire, "a whirlpool will not reap a good return."

As you remodel, try to preserve your house's character. Too many people "remuddle," destroying whatever charm their house had and harming resale value. Wasserman, the Wisconsin architect, and his wife and partner, Caren Connolly, specialize in helping people remodel old bungalows, which though small are often replete with stained glass and ornamental woodwork.

A good way to boost the return on your renovation is to avoid unnecessary costs. You can lower expenses by focusing work on just one section of the house. If you have a two-story house, try to make any additions two stories as well. You'll need a foundation and a roof anyway, and the incremental cost of one more floor is comparatively small. Also, think ahead about how you'll use the space from day to day. Is there a place for the kids to drop their backpacks? If the little things matter to you, then they will probably matter to the next owner as well.

Some homeowners will then put an extravagant free-standing tub in their master bathroom or a bowling alley in the basement because it's what they've always wanted. The rest of us try to strike a balance—as a consumer of housing and as a would-be seller. "I'm always trying to wear both hats," says Muir. "If you go in with eyes wide open and make smart choices," she says, "you can make some nice, happy compromises." That's how to be a model remodeler. ■

ll be lower, though, ou can deduct on up to $100,000 ipal. (You could lose duction if you are to the alternative um tax and use the r something other ur home.)

s are even lower on a Equity Line of Credit, allows you to borrow set amount and draw h as needed. On a 0 line, for example, ay 2.86%. But the t rate floats with erm rates, so payments can go up if, as expected, the Federal Reserve continues to raise rates.

REVERSE MORTGAGES

If you're 62 or older, you're eligible for a reverse mortgage, which allows you to take cash from your home by gradually liquidating some of your equity.

There are several types of reverse mortgages, but the most popular sort—the home equity conversion mortgage—pays you based on factors including interest rates, your age, and your home's value and location. Consider a 71-year-old New Jersey resident with a house worth $300,000. According to the calculator at aarp.org/revmort, he could get a credit line for up to $167,367 or a monthly payment of $1,071, or some combination thereof, for as long as he lives in his home. With a credit line, the unused balance grows over time.

The drawback: Fees can run to 6% of either your home's value or of the federal mortgage insurance limit for your county, which ranges from $160,176 to $290,319. You'll pay whichever is lower. But you won't have to repay the loan or its accrued interest until you move, sell, or die (in which case your estate will repay it). And your debt will never exceed your home's value. The interest rate on a reverse mortgage adjusts either monthly or annually, based on the one-year U.S. Treasury rate. Right now, rates start around 3.5%, with an extra 0.5% added to cover some loan features.

–Anne Tergesen

Expert Insights

Progressive Ideas in Business

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Documenting Risks of Environmental Liabilities for Sarbanes-Oxley

Sarbanes-Oxley requires companies to properly represent their financial situation, using rigid processes to ensure compliance. Using good accounting procedures to set environmental reserves provides a starting point in this process, but now even more documentation is needed.

Expert advice can help turn environmental liability wild cards into well documented risks. Highly regulated environmental management activities, such as air quality compliance or wastewater discharge controls, are predictable and easily documented. Other environmental liabilities are less predictable and may have a huge range of risks. Expert analyses offer a way to document the range of risks.

For example, the typically well definable costs for contaminated property environmental investigation and clean up can quickly escalate in the face of toxic tort or environmental justice lawsuits. Proactive scientific analyses during site investigation processes assist companies in documenting these risks and bounding their magnitude. Determining sources, relative contributions from multiple sources, and relative timing of releases (environmental forensics) helps to resolve complex questions of liability and allocation.

Natural resource damage claims are anot bility that benefits from proactive assess Under Federal law, natural resources inju the release of hazardous substances m restored or replaced, and the public compe for interim losses. A technically sound for evaluating injury to wildlife, water an is essential to the timely and cost-effective tion of claims.

Proactive scientific analyses of product li and safety also helps quantify and mitigate lia associated with product uses and disposal b tifying health and environmental risks befo are wide-spread. In all these cases, obtaining advice early serves the dual purpose of pr documentation and potentially reducing liab

To read the full report, go to www.expert-insights.com/integra

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The New World of Executive Compensation and Benefits

Increased activism by shareholders and Boards, coupled with key new directives from legislators and regulators, have resulted in the most significant transformation in the executive compensation and benefits landscape in over a decade.

Profound changes in program design are being spurred by a renewed focus on the linkage between pay, particularly equity incentives, and real gains in both business results and stock performance. Another major impetus in seeking new directions is the prospect of mandated stock option expensing which, if implemented, will effectively level the playing field for long-term incentives. The hotly-debated change in accounting rules already has renewed interest in alternatives to the once-ubiquitous 10-year non-qualified stock option.

2004 proxy reports reveal a partial shift from options to the use of restricted stock, often with performance-based vesting, as well as the increased prevalence of option programs that incorporate performance requirements. In response to criticism that some employment agreements have rewarded new executives for failure, more up-front equity awards are being designed to include specific performance requirements. The intended result is better-balanced compensation programs designed to reward business achievement that ultimately creates long-term corporate value – rather than just driving short-term stock prices.

On the benefits side, much will depend on th come of proposed moves by Congress and the IR effectively would reduce the attractiveness to em ers and employees of popular deferred compen programs. On the governance front, compani moving to eliminate executive perquisites that c enhance business performance or companies' to attract, retain and motivate top talent. At the time, given many executives' need for financial se and family protection, an estimated increased us Supplemental Executive Retirement Plans (S informally funded with trust-owned life insura expected. Standard group benefit program likely to be further supplemented with exec life, health, disability and long-term care cov

To read the full report, go to www.expert-insights.com/clark.asp

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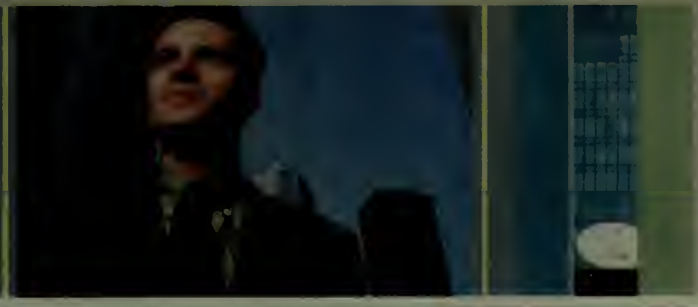

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ecom Auditing: covery vs. Savings

esult of the constant state of flux of the tele- lustry, billing errors are on the rise. While ements in technology have opened new f opportunity in the industry, the same ements (and the resultant stream of mergers uisitions) have proportionately increased the he can of worms known as "billing errors".

are large companies doing to address becoming an epidemic in the telecom y? To reduce costs and recover monies lost dor billing errors, many companies are to another rapidly growing industry: nmunications Outsourcing. The services offered can include: Invoice Processing, Contract Negotiation, Network Optimization and Invoice Auditing. The Invoice Auditing process ideally results in both recovery and savings while the other services are designed to result in savings.

How are telecom outsourcing companies compensated for obtaining refunds or generating savings for your company? Generally these companies receive a negotiated percentage of recovery and/or savings. The difference between "recovery" and "savings"? Sometimes it's hard to know . . . especially when some promotional material refers to "recovered savings"!

Look at it this way: Recovery - in resolution of a claim for overcharges filed by the telecom auditing company, a credit is applied to the client's monthly bill. As compensation the auditing company receives an agreed upon percentage of the credit amount. Correction of the billing error that resulted in the overcharge reduces the client's monthly bill, generating . . . future savings.

The question is – should you pay for those savings? Some contracts for telecom auditing require paying a percentage of future savings in addition to the percentage paid on recovered amounts. However, there are many surprising reasons why those "savings" may not be as projected, may fail to materialize at all, and may actually wind up costing your company money.

To read the full report, go to www.expert-insights.com/faircloth.asp

Faircloth & Blackwelder, founded in 1990, is a telecommunications auditing firm located in the San Francisco Bay Area. The company has provided their service to a diverse corporate client base and successfully resolved claims with a variety of telecom service providers that resulted in the return of millions of dollars to their clients. 415-479-4610 • www.fairclothandblackwelder.com

e Next Time You Negotiate, t a Little Dumb!

best negotiators are "dumb" in the same at Detective Columbo was dumb. They ts of questions. If they don't get a good r the first time, they ask the same question rent way. They don't assume anything, ve to ask "Why?", and they're never shy saying "I don't understand."

d questioning is essential to two types of ating. The first type uses *creative problem* . A skilled negotiator will use graceful, ent questioning to get behind the other positions or demands to find their under- interests. Once you've done that, there's a good chance you'll find a hidden, creative solution that easily satisfies both parties. The questioning helps uncover solutions neither party had in mind at the start of the negotiation.

The second type of negotiating involves *bargaining*, where the parties stake out opening positions and then make compromises and tradeoffs until they reach terms acceptable to both sides. There are no hidden solutions in bargaining negotiations, since the final terms were in view from the beginning, somewhere between the opening positions each party staked out.

Consider this bargaining challenge: If a buyer and a seller negotiate over five price points and three delivery dates, there are *fifteen* different combinations or outcomes available to them. If four warranty packages are also part of the negotiation, there are now *sixty* different combinations available, and each of those combinations produces a different level of satisfaction for each of the parties. A lot of good questioning will be needed if these negotiators hope to find and agree on a combination of terms that serves both parties well.

So asking questions in a negotiation, even dumb ones, is a very smart thing to do.

Follow the link below to find a method for analyzing which outcome is best for both you and the other party in a multi-issue negotiation.

To read the full report, go to www.expert-insights.com/zehrenf.asp

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S S O C I A T E S

David Zehren and Joe Friedman manage a training/consulting firm that helps organizations negotiate, sell, and present more effectively. Since 1989, their firm has conducted seminars in fifteen countries on six continents for sales executives, R&D scientists, lobbyists, bankers, treasurers, purchasing managers, and others in dozens of Fortune 500 and smaller companies. Zehren-Friedman Associates eves there's no such thing as a dumb question, especially in a negotiation. 847-940-7269 • GreatNegotiating@ZehrenFriedman.com • www.ZehrenFriedman.com

Expert Insights

Progressive Ideas in Business

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Competing in a World Economy Means Competing in a World Market!

More and more we are facing global competition. The most fearsome competitor in this new global market is China. China has become a manufacturing hub for the rest of the world. Its booming exports are more than matched by booming industrial imports and foreign investment opportunities. It has become the new engine of global growth (*World economic output:* U.S.A., 21%; EU, 16%; China, 13% (2X since1991) Source: New York Times/12.14.2003). This presents opportunities and challenges!

"There will be more confusion in the business world in the next decade than in any decade in history. And the current pace of change will only accelerate." – Steve Case

In January of 2005 when the GATT agreement goes into effect, the elimination of quotas will take place. The shifting of manufacturing is well on its way in anticipation of this event. Every week there are announcements of shifting production or services to Asia or a low wage country. Where does that leave us?

There are three universal truths about change: (A) Organizations that do not change die. (B) People resist change. (C) It requires time & energy to create change.

Companies need to close the gap from where they are to where they should be. Do we have the expertise and resources to be flexible and change without disrupting current operations?

Companies must realize that:

1. It's already too late!
2. Credibility adds value - Show up; tell t
3. Engineer, Re-Engineer and re-invent your
4. Have a Vision - set clear goals; train & pro incentives for your work force – it is about p
5. Everything is different, everything is same—it's the new economy!

Is there any hope for the Americas? Yes price is not everything! Good managem supply chain components from demand manufacturing to distribution will enable products and services to stay competitive U.S. and this hemisphere.

To read the full report, go to www.expert-insights.com/integrate

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Growing your Business: Realizing the Optimal ROI on Equipment Purchases

All businesses large and small have capital expenditures that require valuable capital resources. There are many options available to acquire business equipment, but which option gives you the most 'bang' for your buck? A nationwide equipment finance service has designed an equipment finance and leasing program that will help answer that question (see company description below).

Equipment leasing has demonstrated to be the most cost effective way to acquire assets and equipment for growing businesses. The tax advantages of leasing coupled with the preservation of capital prove to be the best option for business owners to acquire income producing assets. Growing businesses will tell you that 'cash is king' and the longer you can hold onto cash, the more control you have over the direction to grow your business.

The opportunity cost of not having to tie up valuable cash in fixed income assets is tremendous because there is no limit to that capital earning a higher return invested elsewhere. For example, sales and marketing divisions commonly generate ROI yields in excess of 35%, a much higher return than paying cash for equipment.

Equipment Leasing also serves as the perfect financial product to reduce tax liabilities. S 179 of the IRS business tax code allows bu to deduct $100,000 per year for a 'finance While operating Leases (FMV Leases) p even more effective tax planning strategy b lease payments are 100% tax deductible. L also serves as a tax 'accelerator' since a bu can decide to expense the cost of an asset in years, rather than absorbing 5-7 years t depreciate equipment.

Another key benefit of the lease allow business owner to return the equipment end of lease without any further obligatior

In sum, financing or leasing equip through a nationwide equipment finance s helps your business generate a better ROI.

To read the full report, go to www.expert-insights.com/ACG.asp

American Capital Group (ACG), an INC 500 Company is a proven leader in nationwide equipment finance services. ACG's leasing solutions helped thousands of businesses modernize assets and increase ROIs. Find out how ACG can offer leasing to help your business obtain equip when you need it! For more information, contact Tina Oças at 800-305-0224, ext. 107. www.acgcapital.com

Entertainment

Home Theater's Design Principles re the Same Whatever Your Budget

ROY FURCHGOTT

WHEN I TURNED A WINDOWLESS BASEMENT room into a home theater a little more than two years ago, I first spent months visiting electronics stores, quizzing salespeople, and trolling the Internet. I also called Lewis Lip- the contrabassoonist for the National Symphony Orches- who moonlights as a home-electronics consultant and stician. Lipnick was just finishing up his work on what is ably among the finest home theaters in the world, built for nmunications mogul in Scottsdale, Ariz.

I don't have a mogul's money, but I didn't need it to build a pride-of-the-neighborhood home theater. The design principles are the same, no matter the size of the theater you want or how much you plan to spend. The electronics budget in Scottsdale was $750,000, mine was $7,500. With Lipnick's guidance, I tried to do what he does on a smaller scale—and it worked.

Lipnick, along with an acoustical engineer and interior designer, started the Scottsdale project by making sure the sound stayed in the 26-by-18-foot theater. To do that, they built a room within a room that has its own separate heating and cooling

SCOTTSDALE
A high-end home theater

system so that bass vibrations wouldn't rumble through the ducts to the rest of the house. In my 12-by-11-foot room, isolation is not an issue since I live alone. For the sake of my townhouse neighbors, though, I put no speakers on common walls.

My room still needed special acoustical treatment. No matter how good your audio components—the amplifier and speakers—a room with bad acoustics will ruin the sound. In Scottsdale, the designers used a space underneath the floor to trap boomy bass reflections. They also strategically placed panels on the walls that either diffuse or absorb sound. Without acoustical treatment, fine audio details are lost. You've got the acoustics right when you can close your eyes and the sound seems to be coming from a distance that's beyond your walls. Covering the $40,000 of panels in the mogul's theater was a fabric that allows sound to pass unabated.

For my room, Lipnick suggested using a combined diffuser absorber called a BAD Panel, from RPG Diffusor Systems Inc. Without complex and expensive electronic testing, it was the best solution. Peter D'Antonio, RPG's president, said to cover 60% of the rear wall at ear level with the panels and the side walls between the speakers and the listener as well. "The difference will be staggering," he said. At $2,000 for nine panels, I hoped he was right. He was.

SCREEN SAVOR Furchgott's basement was acoustically challenged

» Tube TV still offers the best color and widest viewing angles

Following the design of the Scottsdale movie palace, I used wainscoting and built recessed bays. There, I hid the panels behind fabric stretched over a wooden frame and kept them in place using Velcro strips. You can't use just any fabric; it needs to be transparent to sound. I used cloth from specialty manufacturer Guilford of Maine. Unfortunately, the pattern I chose was so subtle that the walls looked awfully bare. Some wall hangings would be nice, but I haven't yet found ones that fit the decor and won't interfere with sound.

THE OPTIMUM SIZE

WHAT ABOUT THE VIDEO? For Scottsdale, Lipnick chose an $8,000 12-by-7-ft. screen with microscopic perforations that let speaker sound come right through the screen itself. The image would be cast by a $100,000 high-resolution Digital Light Processor projector from Runco International housed in a soundproof, cooled enclosure, which is also known as a "blimp" or "hush box."

My video decision was somewhat more complex. Projection was out of the question—the room was too small. Rear projection was a possibility, but the cathode ray projection units are large, and require frequent tune-ups. Rear projection liquid-crystal display and digital light processors are hard to see from the periphery, and besides, the black tones aren't very rich. Plasma TV? Pricey. Direct-view LCDs aren't cheap, and like their rear projection counterparts, can be hard to see from off center.

How big did my screen need to be? TV salesmen insisted at least 54 inches. But a thumbnail formula for the optimum standard screen TV is to measure the distance from the best in the house to the screen—in my house 72 inches—and div it by four, which gives you 18 inches. That's the preferred hei of the appropriate size screen. (If you want a widescreen TV, vide the distance by three, not four.) But remember, TV scre are measured diagonally, not by height. A standard 36-inch screen is 22 inches high, which made the TV a little big for but so what? No one ever said "I wish I had a smaller TV bought a 36-in. Sony Wega XBR flat screen for $2,100. (Toc a comparable TV would be about $300 cheaper with more tures.) The conventional tube TV still offers the best color, ri est blacks, and widest viewing angles of any class of sets.

Choosing speakers took still more effort. I subscribe to theory that they should all sound pretty much alike, so I wa ed to match the sound of all the speakers, front, center, and r The front speakers should all be placed on the same plane that the sound effects are properly oriented. For the mog theater, engineer Jerry Steckling custom-built 20 of his pate ed speakers into mahogany cabinets that match the decor.

In my case, I took a few CDs of familiar movie music to au showrooms and tried lots of speakers. Looking for speakers t could convey the drama of movie sound, I chose an NHT m el that cost $1,800 for the full set. Price was a deciding fac The speakers that topped NHT's cost twice as much. I also lil that NHT makes an in-wall subwoofer—the huge speaker t produces low-frequency rumbles you feel in movie explosion which saved crucial space. In fact, I needed two subwoofers small rooms like mine, the long bass waves bouncing arou can cause dead spots and muddy low frequency tones. Two s woofers, strategically placed, allowed for a mostly crisp bas

Dozens of audio-video receivers are on the market, and ev midpriced units are packed with features. The Arizona proj used a $10,000 Media Matrix digital control system ($50,C with add-ons), which is run by software that can be tuned a upgraded with a few stokes on a keyboard. I wasn't so lucky. first A/V receiver, a Sherwood Newcastle R-945, was great about three years, but it lacked Dolby Laboratories Prologic needed to hear satellite TV's audio signal in surround soun bit the bullet and bought an $800 NAD T-752, which had sound modes I most wanted.

Now that some of my equipment is more than three ye old, I've daydreamed about some of the cool, new gear. I heck, the setup is good enough that my friends invite the selves over for movie nights. That should do—for now. ■

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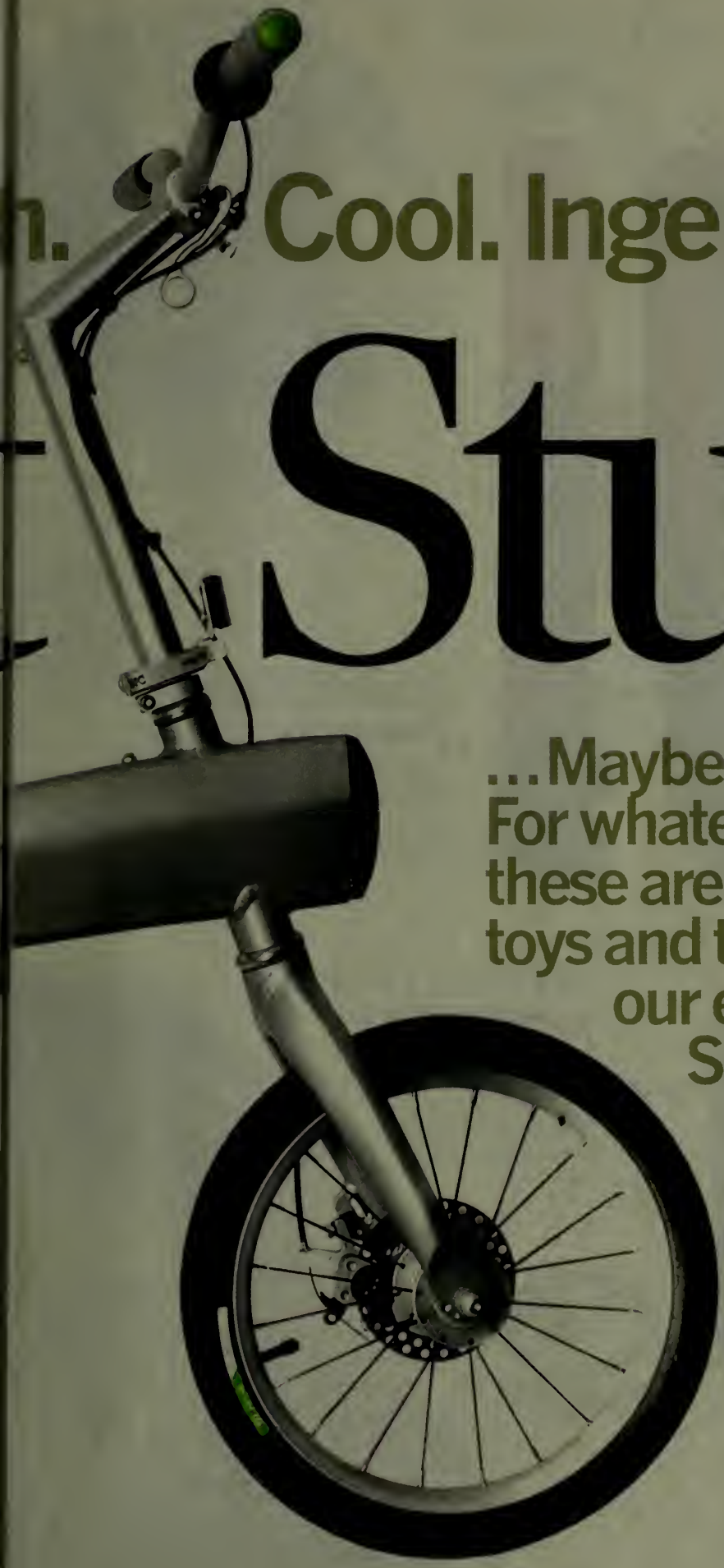


Cool. Ingenious... Stuff

...Maybe even practical. For whatever reason, these are the executive toys and tools that caught our eye this summer. Sure, you can live without them. But go ahead. Splurge a little.

BY LARRY ARMSTRONG

Legal Locks

SEARCHALERT LOCK Airport security now can open many luggage locks with a special tool; only this one ($8) shows a red dot if the bag has been searched.

Vanishing Valise

SPACE MATE This 26-inch upright bag from Atlantic Luggage ($80) flattens down to a slim five inches when empty. That makes it easy to store in cramped quarters, from dorm rooms to cruise ship cabins.

Road Reception

KVH TRACVISION A5 SATELLITE TV ANTENNA This rooftop system ($2,295) brings 138 channels of DirecTV to video monitors in your car. It's $39.99 a month, or $4.99 if you have DirecTV at home.

Wireless Workout

NIKE MP3RUN Strap the MP3 player from Philips ($300) to your arm and the pedometer to a shoe, and you'll hear your speed and pace along with your tunes.

(SEARCH ALERT LOCKS AND MP3RUN) TED MORRISON
(DIGITAL CAMERA INSET) CREATAS/RF

Smart Sucker

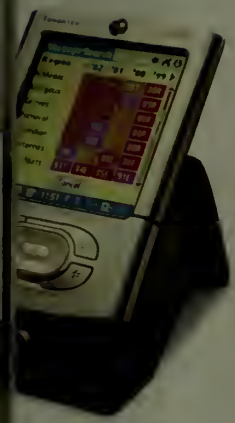
ROOMBA DISCOVERY The new version of iRobot's vacuum ($250) can find its way back to a home base to recharge itself. It has a remote control, the dust bin is bigger, and it's quieter, too.

TV Tamer

HARMONY 688 Connect this home-theater remote from Logitech ($150) to logitech.com/harmony, and it programs itself.

Fast Photos

FERRARI DIGITAL MODEL 2004 This 3.2-megapixel collectible from Olympus ($699) has a hidden 3X zoom lens and a huge display. It's the same red as the sports car and turns on with a "vroom."



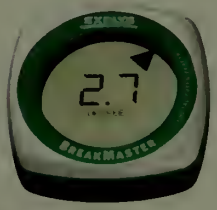
Vintage Virtuoso

PARKER IN YOUR PALM Download this database ($50) to your Palm for tasting notes and ratings for more than 5,000 wines by expert Robert Parker.

Golf Gizmos

STARCADDY Get distance readings on 3,000 courses though your handheld (software, $49; with GPS receiver, $249.)

BREAKMASTER Lay this digital marker ($60) on the green, and you'll get a readout of the downhill direction and angle of the slope to the pin.



BY GENE G. MARCIAL

GROWING DEMAND FOR INFANT FORMULA MAY PUMP UP MARTE

HEARST'S PLAN FOR HEARST-ARGYLE TV IS COMING INTO FOCUS.

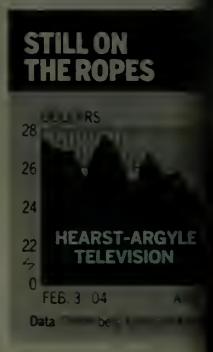
AT PSS WORLD MEDICAL, ROBUST SALES HAVE RIVALS DROOLING

Martek: Bringing Up Baby

MARTEK BIOSCIENCES (MATK) is in an enviable spot: scrambling to meet demand—by tripling capacity of its algae-based nutritional oils for infant formula and dietary supplements. "Martek is a pure play in the fast-growing baby-food market," says Marion Schultheis, managing director at investment firm J&W Seligman, which owns shares. Martek has licensed 14 formula makers that cover the U.S. and most of the world, among them Bristol-Myers Squibb's Mead Johnson unit, Wyeth, Abbott Labs, Novartis, and Nestlé. Schultheis figures major food companies may also want Martek for dairy and cereal products. The oils—O.K.'d by the Food & Drug Administration and patented—are polyunsaturated fatty acids, called DHA and ARA, that help develop babies' eyes and central nervous systems and promote adults' mental and cardiovascular health. Martek's shares, at 70 in May, fell to 45 in July, when worries rose that Martek might fail to meet demand. The stock is now at 51, as supplies keep rising. "We are confident new capacity should make supply-driven noise a thing of the past," says Scott Van Winkle of Adams Harkness, who rates the stock a strong buy. In 2003, Martek earned 61¢ a share and should shoot up to $1.12 in 2004 and to $2.40 in 2005, figures Van Winkle. He sees the stock hitting 80 in a year.

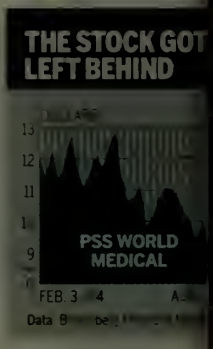
Is Hearst-Argyle TV Going Private?

HEARST-ARGYLE TELEVISION (HTV), spun off in 1997 by media giant Hearst, has been on the ropes since January, when it traded at 29. Now at 23, guess who is buying stock? Hearst itself. Since April, Hearst has bought — through its Hearst Broadcasting unit—1 million shares of Hearst-Argyle in the open market, bringing its total stake of Class A shares to 35%. Hearst-Argyle owns 25 TV stations and manages three others, reaching 18% of U.S. households. The company also manages two radio stations. "It's one of the largest non-network-owned groups," notes Amy Glynn of Standard & Poor's. Hearst Broadcasting already owns 100% of Hearst-Argyle's Class B shares, whose holders pick most of the board. These buys have led some hedge funds to buy, too, in the belief Hearst will take Hearst-Argyle private. They note that Cox Broadcasting recently said it would go private at a 16% premium to its stock price. Meanwhile, Hearst-Argyle has also repurchased 180,000 shares this year. Sean Butson of Legg Mason, who rates the stock a buy with a 12-month target of 35, sees earnings of $1.30 in 2004, up from 2003's $1. Both companies declined comment.



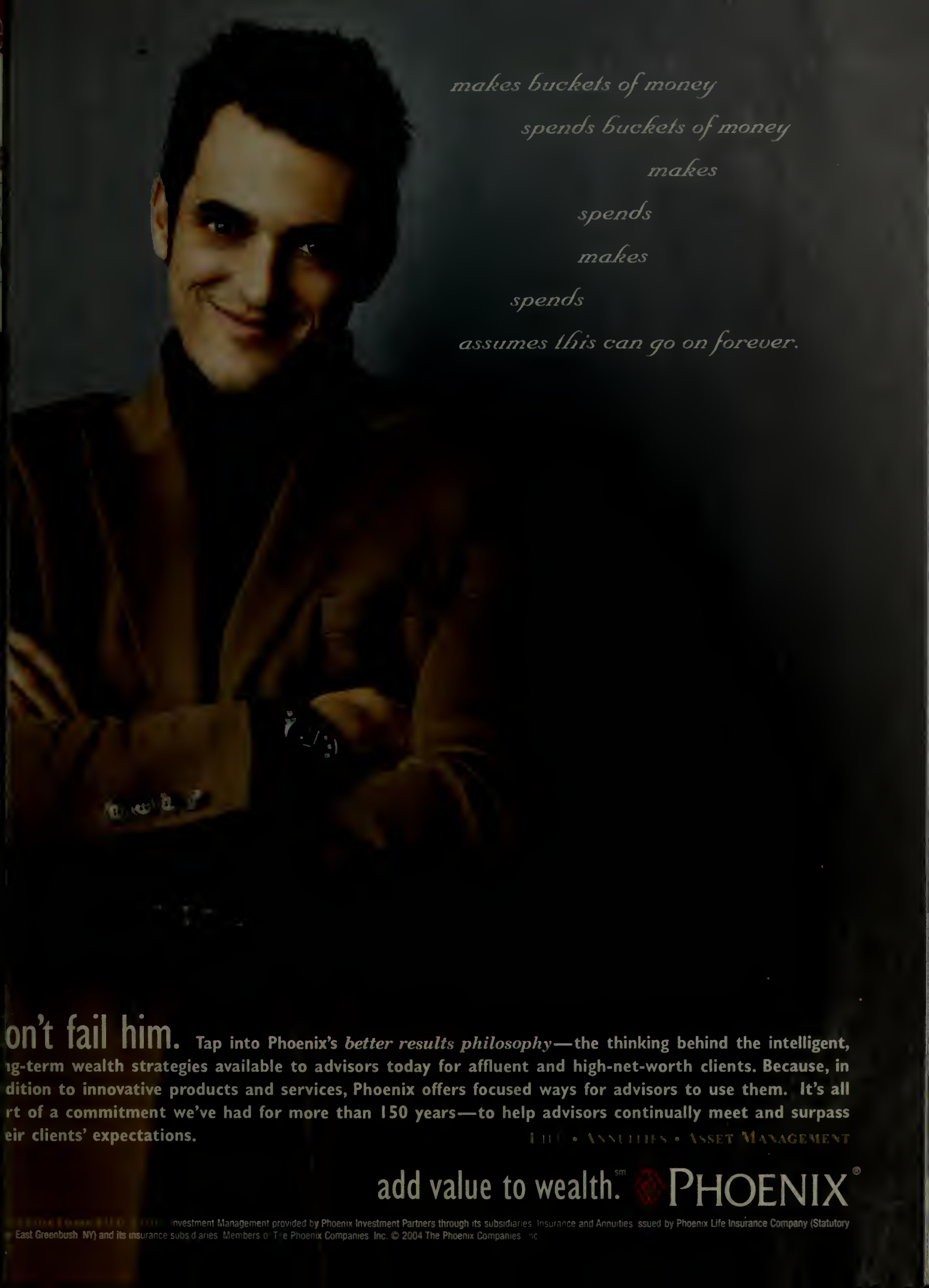
PSS Is Really Delivering the Goods

WHEN DAVID SMITH took the CEO job at PSS World Medical (PSSI) in 2000, sales at PSS—a distributor medical supplies to doctors' offices and nursing homes—stood at $160 million. They've since rocketed to $1. billion. No wonder giants McKesson, a distributor to hospit and pharmacies, and Cardinal Health, a distributor and producer of health-care products, are eyeballing PSS, say son pros: They hope Smith will sell. McKesson's sales are a hefty $70 billion and Cardinal's $56 billion. Smith doesn't deny he has had informal offers, but he wants to build up the stock's worth to more than analysts' 12-month target of 16. "Given the fast growth of PSS, it would not be right to take less than 20," says Smith. Why do McKesson and Cardinal care about PSS? It's the No. 1 distributor to both the elder-care market and the physicians' market. (McKesson is No. 2 in both.) The doctors' business brings in 60% of PSS's sales, and the elder-care market some 40%. Eric Coldwell of securities firm Robert W. Baird puts earnings at 53¢ in fiscal year 2005 ending Mar. 31, vs. 2004's 42¢. For fiscal 2006, he sees 70¢. The stock, now at 9.43, "remains one of our top picks," he says. McKesson and Cardinal didn't return calls for comment. ■



BusinessWeek online Gene Marcial's Inside Wall Street is posted at businessweek.com/today.htm at 5 p.m. EST on the magazine's publication day, usually Thursdays. See Gene on Fridays at 1:20 p.m. EST on CNNfn's *The Money Gang*.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investme banking or other financial relationships with them.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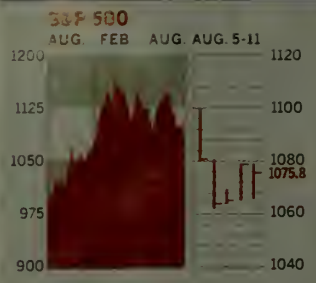
STOCKS



COMMENTARY

The Fed wrapped a ¼-point rate rise in sugar on Aug. 10, sending stocks soaring from the lows set earlier in the week. While citing the current softness, Greenspan & Co. stressed the recovery's underlying strength. The next day, though, tech stocks slid after Cisco reported strong earnings but wariness among customers, suggesting businesses may not share the Fed's good cheer.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS

	AUG. 11	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1075.8	-2.1	-3.2	9.7
Dow Jones Industrials	9938.3	-1.9	-4.9	7.8
NASDAQ Composite	1782.4	-3.9	-11.0	7.3
S&P MidCap 400	557.8	-2.4	-3.2	14.6
S&P SmallCap 600	269.0	-2.7	-0.5	18.7
DJ Wilshire 5000	10,434.9	-2.1	-3.4	10.6

SECTORS

BusinessWeek 50*	616.0	-2.3	-1.0	7.2
BW Info Tech 100**	310.2	-3.7	-11.5	3.4
S&P/BARRA Growth	525.7	-2.3	-5.4	6.0
S&P/BARRA Value	546.1	-1.8	-1.1	13.5
S&P Energy	249.8	-2.7	11.4	27.8
S&P Financials	372.2	-1.0	-2.0	9.7
S&P REIT	120.6	-1.5	4.2	16.4
S&P Transportation	195.2	-2.5	-3.3	9.9
S&P Utilities	124.1	0.3	4.8	18.8
GSTI Internet	128.5	-3.7	-11.2	8.0
PSE Technology	633.0	-4.2	-9.2	9.7

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	AUG. 11	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1111.9	-1.6	-5.7
London (FT-SE 100)	4312.2	-2.2	-3.7
Paris (CAC 40)	3503.0	-2.9	-1.5
Frankfurt (DAX)	3678.9	-3.8	-7.2
Tokyo (NIKKEI 225)	11,049.5	0.4	3.5
Hong Kong (Hang Seng)	12,343.1	0.5	-1.9
Toronto (S&P/TSX Composite)	8168.2	-2.3	-0.6
Mexico City (IPC)	9849.9	-2.2	12.0

FUNDAMENTALS

	AUG. 10	WEEK AGO
S&P 500 Dividend Yield	1.73%	1.69%
S&P 500 P/E Ratio (Trailing 12 mos.)	19.2	19.7
S&P 500 P/E Ratio (Next 12 mos.)*	15.8	16.1
First Call Earnings Revision*	-0.03%	0.16%

*First

TECHNICAL INDICATORS

	AUG. 10	WEEK AGO
S&P 500 200-day average	1108.4	1107.6
Stocks above 200-day average	41.0%	50.0%
Options: Put/call ratio	0.90	0.70
Insiders: Vickers NYSE Sell/buy ratio	3.19	3.27

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Photographic Products	9.6	Internet Software	89.8
Tires & Rubber	7.8	Steel	77.5
Intgrd. Telecomms. Svcs.	7.1	Fertilizers & Ag. Chems.	69.2
Steel	6.6	Tires & Rubber	67.3
Homebuilding	5.1	Oil & Gas Refining	60.9

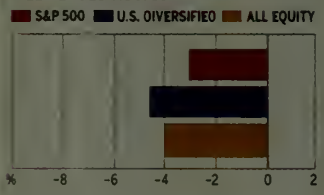
WORST-PERFORMING GROUPS

	LAST MONTH %	
Semiconductors	-16.8	Airlines
Semiconductor Equip.	-16.7	Health-Care Distributors
Instrumentation	-16.7	Semiconductor Equip.
Casinos	-15.6	IT Consulting
Communication Equip.	-14.8	Biotechnology

MUTUAL FUNDS

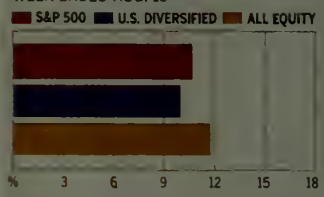
4-WEEK TOTAL RETURN

WEEK ENDED AUG. 10



52-WEEK TOTAL RETURN

WEEK ENDED AUG. 10



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
Utilities	1.4	Latin America	32.8
Latin America	1.0	Natural Resources	30.3
Real Estate	0.4	Japan	28.0
Pacific/Asia ex-Japan	-0.4	Real Estate	23.9
LAGGARDS		**LAGGARDS**	
Technology	-8.2	Technology	2.1
Japan	-8.2	Health	4.0
Small-cap Growth	-7.9	Large-cap Growth	4.6
Health	-7.4	Small-cap Growth	6.2

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		**LEADERS**	
ProFds. USh. Sm. Cap Inv.	11.5	iShares MSCI Austria Idx.	61.4
ProFunds UltSh. OTC Inv.	11.4	ProFds. Wriss. Ultsr. Inv.	58.1
Rydex Dynam. Vent. 100	11.4	Bruce	53.2
ProFds. USh. Mid Cap Inv.	8.0	U.S. Glbl. Accde. E. Eurpn.	52.0
LAGGARDS		**LAGGARDS**	
ProFds. Intnet. Ultsr. Inv.	-19.1	Ameritor Investment	-30.6
Reynolds	-18.9	Grand Prix A	-26.4
Amerindo Technology D	-17.4	Frontier Equity	-24.1
ProFds. Intnet. Ultsr. Inv.	-17.3	ProFunds UltSh. OTC Inv.	-24.1

INTEREST RATES

KEY RATES

	AUG. 11	WEEK AGO
Money Market Funds	0.91%	[illegible]
90-Day Treasury Bills	1.44	1.48
2-Year Treasury Notes	2.50	2.65
10-Year Treasury Notes	4.28	4.43
30-Year Treasury Bonds	5.06	5[illegible]
30-Year Fixed Mortgage†	5.80	5.97

†BankRate

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Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR BOND	30-YR
General Obligations	3.6[illegible]	[illegible]
Taxable Equivalent	5.24	6.[illegible]
Insured Revenue Bonds	[illegible]	[illegible]
Taxable Equivalent	5.50	7.1[illegible]

THE WEEK AHEAD

CONSUMER PRICE INDEX *Tuesday, Aug. 17, 8:30 a.m. EDT* » July consumer prices for goods and services are forecast to have increased by 0.2%, after a 0.3% gain in June. That's based on the median forecast of economists surveyed by Action Economics. Minus food and energy, core prices probably moved up 0.2%, after a 0.1% gain in June.

RESIDENTIAL CONSTRUCTION *Tuesday, Aug. 17, 8:30 a.m. EDT* » Housing starts probably rebounded to an annual rate of 1.87 million in July. In June, sales slipped to an annual pace of 1.8 million.

INDUSTRIAL PRODUCTION *Tuesday, Aug. 17, 9:15 a.m. EDT* » Industrial output is expected to have expanded by 0.5% during July, following a decline of 0.3% for June. The forecast is bolstered by an increase in employment and a longer workweek among manufacturers. After slipping back to 77.2% in June, the average operating rate very likely moved back up to 77.4% in July.

LEADING INDICATORS *Thursday, Aug. 19, 10 a.m. EDT* » The Conference Board's July index of leading economic indicators most likely rose 0.2%, after a 0.2% fall in June. The rebound should be aided by more bullish data on factory activity and consumer sentiment.

The *BusinessWeek* production [illegible] declined to 223.6 for the p[illegible] ended July 31 but remained 11.[illegible] above its year-ago level. B[illegible] calculation of the four-week m[illegible] average, the index rose to 224.4.

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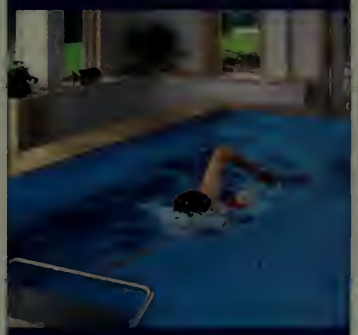

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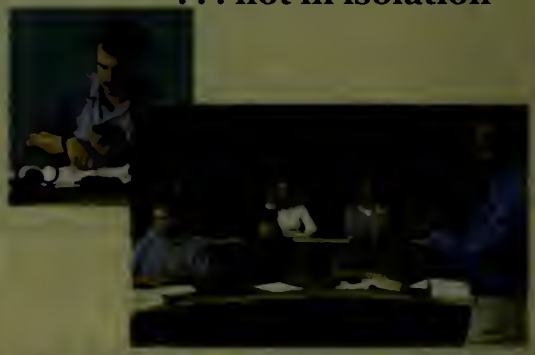

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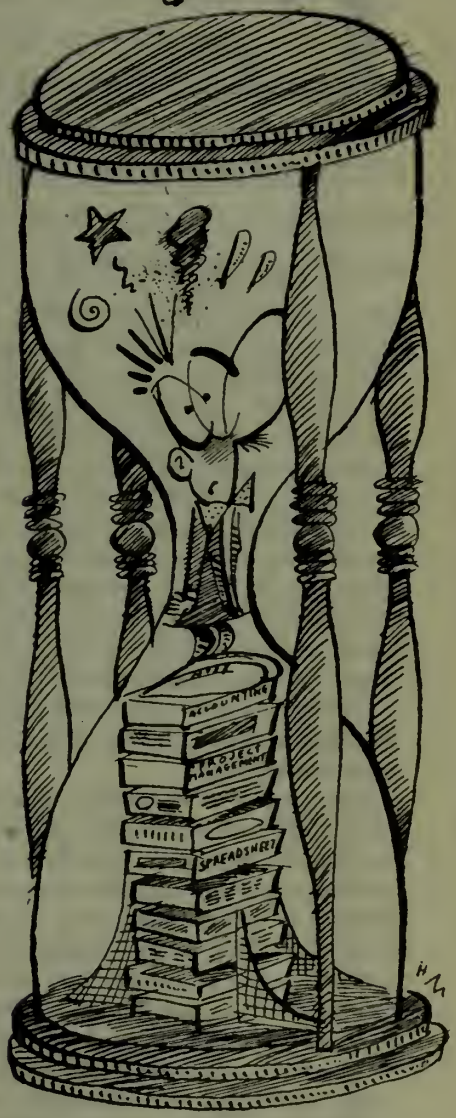

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Four Sensible Ways to Break Our Dependence on Foreign Oil

ECONOMISTS OFTEN UNDERestimate the impact of oil on the U.S. economy. Yet rising oil prices, up 40% in the past year and doubled since 2002, are undermining consumer spending and CEO confidence. The effect is significant enough for the Federal Reserve to attribute the slowing of U.S. growth and surprising weakness in the job market to higher energy prices: "This softness likely owes importantly to the substantial rise in energy prices," it said recently. What the Fed didn't say is that the tight supply-and-demand conditions sending oil prices skyrocketing toward $50 a barrel may not be as fleeting as economists, policymakers, and oil-company executives would have us believe.

BusinessWeek has long advocated sensible steps to cut oil consumption and raise production of alternative energy sources (BW—Feb. 24, 2003). But gridlock in Washington and opposition in Detroit have blocked such obvious actions as raising 25-year-old CAFE mileage standards or ending the fiction that sport-utility vehicles are trucks, not cars, and thus exempt from higher automobile-mileage standards. Upping existing gasoline taxes, a policy favored by many experts, isn't open to discussion.

Rising global demand will probably keep markets tight for years. China's oil imports are up sevenfold since 1998. Japan is growing robustly again. And the U.S. continues to increase its record energy consumption due to strong growth and its affection for gas-guzzling SUVs. Supply, meanwhile, remains constricted. OPEC and Big Oil are not investing enough in exploration despite the runup in prices. Politics is making production in Russia, Nigeria, Venezuela, and Iraq uncertain. And hedge funds are playing in the oil markets, exacerbating price swings. All in all, the current risk premium built into oil prices —$10 to $15 a barrel—may remain for a long time (page 44).

What to do? Here are four proposals that can lower U.S. energy consumption and dependence on overseas oil. The plans can be financed by reducing federal subsidies for energy giants that are awash in profits but prefer to buy back stock rather than risk building new refineries or exploring for oil.

SUVs, light trucks, and cars consume nearly half of all oil in the U.S. Increasing gas mileage is the fastest way to reduce energy use, and hybrids are the best means to do that. Offering consumers tax credits of $3,000 per vehicle for tw million cars, SUVs, and trucks would cost $6 billion and co be spread over five years. The tax credits would offset the higher cost of hybrids, accelerate demand, and speed the transition to a higher-mileage fleet. This step makes sense

So does boosting investment in alternative fuels. Wind generation is competitive in many regions of the country: General Electric Co. has made it a $1 billion business. Sol energy technology is making incremental strides. New nuclear-reactor designs are cheaper and safer. And hydro has great potential for cars and for generating electricity. nuclear and hydrogen have big obstacles to overcome. A s way to dispose of nuclear waste must be found. And an eff cient means of producing hydrogen has yet to be develope Still, a combination of alternative fuels has the potential to reduce America's oil habit over the long run.

Raising the energy efficiency of appliances, office buildi and homes could cut energy use as well. Europe has far hi standards than the U.S. Companies such as Gap Inc. and Toyota Motor Corp. are savin big money by constructing "green" headquarters with n efficient cooling and heating systems, solar roofs, and mechanisms to shut off light and dim computers when pe aren't in their offices. Washington can help by rais standards for air conditioner refrigerators, and other appliances.

Supply may well be tight for years. America needs a new energy policy

Washington should also revisit its antitrust policy. Th wave of energy-company mergers in the '90s may have m sense when oil was at $10 a barrel and there was excess capacity. But at $40 to $50 per barrel and with markets tig as a drum, the mergers in retrospect are questionable. Refinery capacity, now in short supply, was cut in the consolidation, and the competitive drive to open expensiv new oil fields may have been curbed. Big Oil now acts mor like a risk-averse bank than a wildcatter, following Wall St dictates on cash flow instead of Texas traditions of risk-tak Is America well served by the antitrust policies of the '90s not, is it too late to undo the damage?

None of this is going to make a huge difference overnig but clearly this is the time to start. The U.S. has to stop binging on energy, especially imported oil. It is bad econo policy. It is bad geopolitical policy. It is bad environmental policy. America needs a new energy direction.